1028

HOUSING AND THE ECONOMY

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

SECOND SESSION

APRIL 16 AND SEPTEMBER 17, 1980

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

72-946 O WASHINGTON : 1981

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

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HOUSING AND THE ECONOMY

WEDNESDAY, APRIL 16, 1980

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 2:35 p.m., in room 6226, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senators Bentsen, Sarbanes, Javits, McClure, and Jepsen; and Representatives Mitchell, Brown, Heckler, and Wylie.

Also present: John M. Albertine, executive director; Deborah Matz and Mayanne Karmin, professional staff members; Betty Maddox, administrative assistant; Charles H. Bradford, minority counsel; and Mark R. Policinski and Carol A. Corcoran, minority professional staff members.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. The hearing will come to order.

I'm really pleased we have such a distinguished panel of witnesses for the committee's first quarterly hearing on housing and the economy. Because of the important role the housing industry plays in our national economy and because often our national economic policies severely impact the housing industry, it is extremely important that the housing starts be closely monitored. Therefore, in addition to the committee's monthly unemployment and inflation hearings, starting today we are implementing quarterly housing hearings.

Unfortunately, we are off to a rather inauspicious beginning. Since October, the prime rate has soared. Notwithstanding the prime rate's unprecedented rate of 20 percent, inflation has not been slowed, much less halted. While we all suffer from the effects of inflation in our economy, and we all, therefore, must make certain sacrifices to bring inflation under control, it appears that homebuilders are being asked to shoulder a disproportionate share of the burden.

Housing starts for the month of March were disastrous, falling by 22 percent from February to a seasonally adjusted annualized rate of 1 million units. Housing starts for the first quarter of 1980, therefore, are 27 percent below last year's level. Even more startling is the fact that building permits have fallen below 1 million to 941,000 at an annual rate—a 40-percent drop from March 1979.

While this news may seem grim, with mortgage interest rates remaining as high as they are, there is no reprieve in sight. Mortgage interest rates have risen to a range of 15 to 17 percent in recent months and, as of yet, there is no indication of a downturn. That is, if you can get the mortgage money.

What really concerns me is that we've got a situation where the big multinational corporations can go to the Eurodollar market and to other sources. We've got a situation where the large banks will take care of the big customers because they are afraid they're going to lose them to the competitor. But housing really gets put through the ringer on this.

What we have seen is a situation where Congress has not measured up to its responsibility in ending deficit spending, and where we have depended too much on the Fed to take care of inflation. The result is we always have this boom and bust in housing. By wringing out the housing industry, we chase carpenters, plumbers, and other construction workers into other occupations, because they say, "I have had enough with this boom and bust and these kinds of layoffs." And then once we recover from the "bust," we wonder why we can't find the carpenter who is experienced and can do the job, or we can't find the plumber or the electrician. Well, they have gone off to do something else. They are running a carwash or have decided to become mechanics. But they have had enough of the housing industry.

Now, if we're going to develop efficiency in the housing industry, if we're going to encourage the long-term capital commitments that have to be made, we have to have some better answers and more stability in this housing industry. And I'm looking forward to the testimony from this distinguished panel that we have here today.

Before continuing, I will place the April 16 press release of the Bureau of the Census, Department of Commerce, entitled "Housing Starts and Building Permits in March 1980," in the hearing record.

[The press release follows:]

[Bureau of the Census Press Release, Department of Commerce, April 16, 1980]

HOUSING STARTS AND BUILDING PERMITS IN MARCH 1980

PRIVATELY OWNED HOUSING STARTS

Privately owned housing units were started in March 1980 at a seasonally adjusted annual rate of 1,041,000 according to estimates reported today by the Bureau of the Census, U.S. Department of Commerce. This is 22 percent below the revised annual rate of 1,332,000 for February 1980 and 42 percent below the rate of 1,800,000 for March 1979.

The March 1980 seasonally adjusted annual rate for single-family housing starts was 606,000 compared with the revised February rate of 789,000 units. The rate in March for units in buildings with five units or more was 345,000 compared with the revised February rate of 443,000. The March rate for units in buildings with two to four units was 90,000. Housing starts do not include mobile homes. Mobile home shipments through February 1980 are shown in table 3.

During the first 3 months of this year, 238,800 housing units were started compared with 325,600 units for the same period in 1979, a decrease of 27 percent.

BUILDING PERMITS

New privately owned housing construction was authorized in March 1980 at a seasonally adjusted annual rate of 941,000 units in the 16,000 permit-issuing places. This is 18 percent below the revised rate of 1,142,000 for February and 42 percent below the rate of 1,621,000 for March 1979.

New single-family units were authorized in March 1980 at a seasonally adjusted annual rate of 535,000 units compared with the revised February rate of 695,000. Units in buildings with five units or more were authorized in March at an annual rate of 310,000 compared with the revised February estimate of 341,000. The March rate of permit authorized units in buildings with two to four units was 96,000.

During the first 3 months of this year, 233,200 units were authorized by permits compared with 327,000 units for the same period in 1979, a decrease of 29 percent.

In interpreting changes in housing starts and building permits, note that month-to-month changes in seasonally adjusted statistics often show movements which may be irregular. It may take 3 months to establish an underlying trend for total starts and 2 months for total building permit authorizations.

The statistics in this release are estimated from sample surveys and are subject to sampling variability as well as errors of response and nonreporting. Estimated relative standard errors for preliminary data are shown in tables 1 and 2. An explanation of the reliability of the data appears in the appendix to Construction Report, C20-80-1.

Table 1. NEW PRIVATELY OWNED HOUSING UNITS STARTED

(In thousands of units. Details may not add to total because of rounding)

Period	Total	In structures with—				Region			
		1 unit	2 units	3 and 4 units	5 units or more	North-east	North Central	South	West
1a. Seasonally adjusted annual rate									
1979 - March	1,800	1,275	119		406	190	368	780	462
April	1,750	1,273	113		364	171	356	692	531
May	1,801	1,229	120		452	173	396	734	498
June	1,910	1,276	123		511	178	371	862	499
July	1,764	1,222	130		412	174	356	762	472
August	1,788	1,237	152		399	176	388	770	454
September	1,874	1,237	123		514	164	392	765	553
October	1,710	1,139	129		442	172	317	765	456
November	1,522	980	114		428	170	249	716	387
December	1,543	1,055	110		383	156	326	667	399
1980 - January[r]	1,419	1,002	127		290	194	213	673	339
February[r]	1,332	789	100		443	67	228	703	334
MARCH[p]	1,041	606	90		345	104	185	507	245
Relative standard error of preliminary estimates (%)	6	4	11		16	27	23	7	6
1b. Not seasonally adjusted									
1979 - March	152.9	109.8	5.0	5.1	33.1	12.2	25.7	74.6	40.4
1980 - January[r]	73.1	49.3	3.7	3.4	16.7	5.6	5.6	39.7	22.2
February[r]	80.3	50.3	2.3	2.9	24.7	2.3	7.9	46.9	23.3
MARCH[p]	85.4	51.2	4.1	3.7	26.3	7.2	12.4	44.8	21.0
Relative standard error of preliminary estimates (%)	6	4	9	22	16	27	23	7	6
1c. In 16,000 permit-issuing places—seasonally adjusted annual rate									
1979 - March[1]	1,488	1,013	113		362	184	283	576	445
1980 - January[r]	1,315	899	126		290	181	202	593	339
February[r]	1,224	684	100		440	67	214	609	334
MARCH[p]	965	530	90		345	104	175	441	245
Relative standard error of preliminary estimates (%)	6	4	11		16	27	25	7	6
1d. In 16,000 permit-issuing places—not seasonally adjusted									
1979 - March[1]	125.1	85.8	4.6	5.0	29.7	11.9	19.6	54.6	39.0
1980 - January[r]	68.0	44.2	3.6	3.4	16.7	5.3	5.3	35.1	22.2
February[r]	73.1	43.3	2.3	2.9	24.6	2.2	7.4	40.1	23.3
MARCH[p]	78.4	44.2	4.1	3.7	26.3	7.1	11.7	38.5	21.0
Relative standard error of preliminary estimates (%)	6	4	9	22	16	27	25	7	6

In addition, public housing starts for March 1979, January, February and March 1980 (in thousands of units) were 0.4, 0.3, 0.7, and 1.0 respectively.

— Represents zero. [p]Preliminary. [r]Revised. Z Less than 50 units.
[1] For 14,000 places.

Table 2. PRIVATELY OWNED HOUSING UNITS AUTHORIZED BY BUILDING PERMITS IN PERMIT-ISSUING PLACES

(In thousands of units. Details may not add to total because of rounding)

Period	Total	In structures with— 1 unit	2 units	3 and 4 units	5 units or more	Region North-east	North Central	South	West
2a. Seasonally adjusted annual rate (16,000 permit-issuing places)									
1979 - March	1,621	1,056	126		439	151	303	713	454
April	1,517	1,036	119		362	147	304	583	483
May	1,618	1,047	116		455	181	328	616	493
June	1,639	1,012	132		495	199	332	636	472
July	1,528	1,001	135		392	161	281	585	501
August	1,654	1,030	151		473	147	310	664	533
September	1,775	1,015	151		609	217	337	704	517
October	1,542	927	137		478	151	271	673	447
November	1,263	751	99		413	152	191	557	363
December	1,244	780	119		345	144	224	517	359
1980 - January	1,264	761	121		302	116	221	577	350
February r	1,142	695	106		341	125	178	524	315
MARCH p	941	535	96		310	125	132	430	253
Relative standard error of preliminary estimates (%)	2	1	5		6	15	4	2	2
2b. Not seasonally adjusted (16,000 permit-issuing places)									
1979 - March	149.4	98.8	6.0	6.0	38.6	12.7	26.2	68.3	42.1
1980 - January	74.5	44.2	3.3	4.0	22.9	5.2	7.6	38.7	22.9
February r	76.1	46.5	3.6	3.6	22.3	5.4	7.9	39.2	23.6
MARCH p	82.6	47.9	4.4	4.3	25.9	10.2	10.8	39.3	22.2
Relative standard error of preliminary estimates (%)	2	1	8	5	6	15	4	2	2
2c. Not started at end of period—not seasonally adjusted (16,000 permit-issuing places)									
1979 - March [1]	240.0	102.7	18.0		119.3	40.6	33.4	100.8	65.2
1980 - January r	186.5	76.7	13.9		95.9	31.8	21.3	87.1	46.3
February r	184.9	80.6	16.9		87.3	34.6	20.1	84.7	45.6
MARCH p	185.3	84.5	16.7		84.1	35.6	19.2	85.1	45.4
Relative standard error of preliminary estimates (%)	5	5	9		7	11	21	7	6

p Preliminary r Revised.

[1] For 14,000 places

Table 3. MANUFACTURERS' SHIPMENTS OF MOBILE HOMES AND PRIVATELY OWNED HOUSING UNITS STARTED

(In thousands of units)

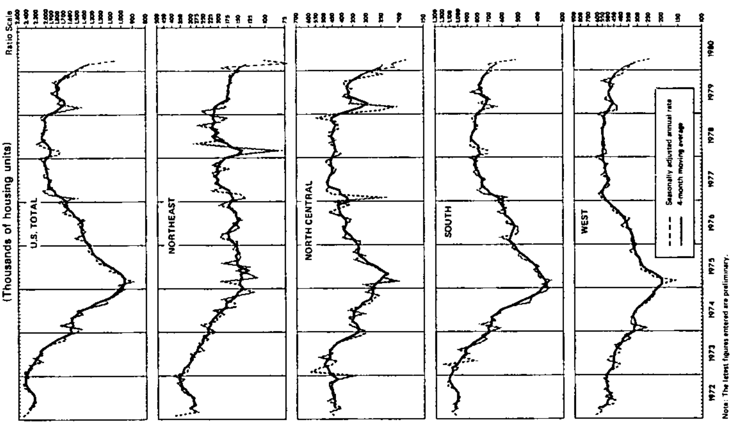
Period	Seasonally adjusted annual rate: Manufacturers' shipments of mobile homes	Single family structures started plus mobile home shipments	Total housing units started plus mobile home shipments	Not seasonally adjusted: Manufacturers' shipments of mobile homes	Single family structures started plus mobile home shipments	Total housing units started plus mobile home shipments
1979 - February	276	1,273	1,745	18.7	78.0	103.3
1980 - January r	276	1,278	1,695	18.1	67.4	91.2
February p	270	1,059	1,602	18.8	69.2	99.2
MARCH	(NA)	(NA)	(NA)	(NA)	(NA)	(NA)

NOTE: The statistics on manufacturers' shipments of mobile homes are provided by the National Conference of States on Building Codes and Standards (NCSBCS).

NA Not yet available p Preliminary. r Revised figures are for housing units started. X Not applicable.

NEW PRIVATELY OWNED HOUSING UNITS STARTED

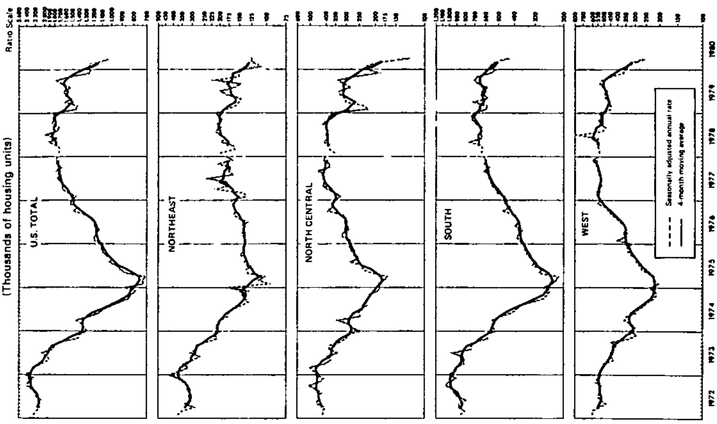
(Thousands of housing units)



Note: The latest figures entered are preliminary.

NEW PRIVATELY OWNED HOUSING UNITS AUTHORIZED IN 16,000 PERMIT-ISSUING PLACES

(Thousands of housing units)



Note: The latest figures are preliminary. Data for January 1978 and later months are for 16,000 permit-issuing places, and 1972 through 1978 are for 14,000 places.

Senator BENTSEN. I would like to now defer to Congressman Brown, the ranking minority member.

OPENING STATEMENT OF REPRESENTATIVE BROWN

Representative BROWN. Thank you, Mr. Chairman. Let me express my appreciation to you for calling these hearings.

The economic crisis that's gripping the country has rocked the housing industry and the building industry in my part of the United States. Briefly stated, the present situation is one in which mortgage lenders can't lend, homebuilders can't build, home buyers can't buy, and general contractors can't build because their customers aren't buying either.

In many areas of my district in Ohio, homebuilders have shut down their operations and housing starts are down as much as 50 percent. Home buyers are facing mortgage rates of 15 percent and above. The Associated Builders and Contractors, some of whom are here today, general contractors for the most part, are in serious difficulty. Savings and loan institutions are being battered by disintermediation and are not, cannot in fact, make long-range mortgage commitments.

Unemployment in the local housing industry is near 50 percent in many communities and will get even higher as suppliers and subcontractors are affected by the slump. This is the picture in my district and I'm sure that it is the same across the country.

The housing industry is the first casualty in the administration's planned recession, brought about by myopic economic policies of uncontrolled spending and high taxes. The major problem affecting lender, builder, and buyer is the high rate of interest.

But we must remember that the major reason interest rates are so high is because of high inflation and not because money growth is being slowed. If we must have tight credit to fight inflation—and it appears that we must—the question then becomes, who gets it. Does it go to the private sector to sustain housing, autos, investment, and jobs? Or does it go to the government? Government can grab most of our dwindling supply of credit by running more deficits, both on budget and off budget.

But consumers, small businesses, banks, and savings and loans are already being squeezed dry, largely because government is gobbling up what little credit there is to finance the growing Federal deficit.

If government chooses to continue spending at record levels and grabs more of the scarce credit, many people and businesses will be bankrupt. If this occurs, the Fed will be forced to reverse its tight credit policies, and that will be the end of the fight against inflation.

What we need are deep spending cuts, not higher taxes, so that the Federal Government can balance the budget, end its borrowing, get out of the credit markets, and leave whatever limited money there is to the private sector at lower interest rates. Then we can begin a program of supply side tax cuts aimed at increasing the saving and investment we need to modernize our factories, preserve jobs and fight inflation by putting more goods on the shelf.

Mr. Chairman, I thank you for the opportunity to make this statement and I look forward also to the testimony from the witnesses, and to an answer to the current problems, which I think we have given you some points about.

Senator BENTSEN. Thank you very much, Congressman Brown.

I think we have a very interesting panel here, and some of the members of the panel are intimately connected with the problem and hopefully have the answers. And I'm going to look forward to hearing from them.

The first one will be Michael J. Stephens, who is president of S & M Builders of Virginia, Inc. Why Mr. Stephens? Well, because Mr. Stephens called in a month or so ago and he said—and you can correct me, Mr. Stephens—but as I understand it, you said that you build about 20 homes a year and you are in a position of putting the shovel in the ground and starting on about 10 of them, and perhaps could have them finished by next fall. But you weren't sure you were going to have any buyers who could qualify for these kinds of interest rates and these kinds of loans.

And I think this exemplifies the problem that we are facing in this industry—not some giant corporation, but a relatively small independent businessman, who is simply trying to build homes.

We have the Honorable Jay Janis, Chairman of the Federal Home Loan Bank Board, a man who shares a deep concern with us for this problem and hopefully can give us some answers as to what we can do about it; and the Honorable J. Charles Partee, a distinguished Governor of the Federal Reserve Board; and Jack Carlson, who has testified before us a number of times, who is the executive vice president and the chief economist of the National Association of Realtors.

Mr. Stephens, I want you to proceed first, because I want these fellows to ponder what you have to say. Then we will hear from them.

STATEMENT OF MICHAEL J. STEPHENS, PRESIDENT, S. & M. BUILDERS OF VIRGINIA, INC., FAIRFAX, VA.

Mr. STEPHENS. Gentlemen, my name is Michael Stephens. I'm the president of S. & M. Builders of Virginia, Inc.

Senator BENTSEN. We have a large audience which wants to hear what you have to say. So if you will move that microphone close.

Mr. STEPHENS. My name is Michael Stephens. I'm the president of S. & M. Builders of Virginia, Inc., a homebuilding company. For the last 4 years, since I have been in business for myself, I have built between 15 to 20 homes a year in the northern Virginia area right outside Washington.

I sincerely appreciate this opportunity to offer testimony before this committee with respect to the topic of this hearing, the effect of interest rates on the housing industry and the outlook ahead.

Let me begin by telling you first the circumstances which brought me here before you today. On March 6 of this year, the largest savings and loan in the Washington metropolitan area announced that its permanent loan rate was 17 percent. Fearing a repeat of 1974, I called several other area banks and savings and loans to find out their understanding of the money market. Since December, or in December, every one of them had predicted a slight softening of the interest rates in the spring of this year. Not one of the bank executives, its president and two vice presidents, could tell me for certain what was happening, and their personal opinions were so varied as to what was happening that no consensus could be taken.

My situation at that time was one that the housing industry has never faced before to its present extent. We had sold four houses in January and February of that year, just before the rate started going up. The dilemma I was faced with was whether or not to build these houses or rip up the contracts.

As you are aware, most, if not all, permanent lenders will only commit funds 60 days; that is, 2 months prior to settlement on the property. Now, if I built these homes and the permanent interest rate prior to their settlement was 17 percent, the purchasers would not be able to qualify for their mortgages. And since every contract is contingent upon financing, I would be stuck with these homes in inventory, which would jeopardize any hope of financial survival that this situation has caused.

My other alternative was to tell these purchasers that I would default on my contracts with them, which would leave me open to lawsuits. Either way, I would lose. A classic catch-22 type of situation and not the type that any American businessman should be forced into.

I needed some concrete information to base my decision on. So I started to call any Government agency to give me some aid. I first called the Federal Reserve Board and asked to talk to Paul Volcker. I was told that he wasn't there. So I spoke to his assistant, Mr. Corrigan. After stating my problem and listening to it, he told me that the Federal Reserve looks at money with an unemotional view, without regard to any particular segment of the economy; that the overall money supply is their concern.

He said that their discount rate has no direct effect on mortgage rates. After I questioned that statement, he backed off. He said it may have an indirect effect.

Also, I couldn't pick any—excuse me. They couldn't pick any particular segment of the money market to constrain without presidential action. He told me inflation was a terrible thing and they had to bring it under control. I asked him if by raising interest rates it wasn't like putting a fire out with gasoline. He said he didn't think so and wouldn't describe their action that way. No help there.

I next called Senator Proxmire's office and spoke to his staff assistant on the Senate Banking Committee, who told me that their committee was in the legislative branch. And though she told me of certain legislative bills that they were working on, these were about 1 year away in the future. However, any current action would be found in the executive policymaking committees. She referred me to this committee, and I talked to an economist, whose help was welcome, but she couldn't answer my questions or help me in making any decisions.

She referred me to the Federal Home Loan Bank Board. I called Mr. Del Riordan. Mr. Riordan couldn't tell me anything on the current situation, he saw short-term rates declining earlier than long term and that the long-term might start softening this fall, although he thought the new rollover mortgages would help the thrift institutions in making loans available, especially if they were offered at initial discount rates.

I finally consulted with my partner and decided to go ahead with the construction of these homes, based on a gut feeling rather than gathered intelligence. I hope it wasn't stupidity.

This is only one way in which interest rates affect the industry. It is a severe example, by the way. We don't normally have to do this, but today that, my friends, is the situation. It's ridiculous.

High interest rates are inflationary in themselves. Let me give you an example, comparing the cost effects of today's high prime and permanent rates on the purchase of one of my homes to the same cost under normal market conditions. This example is based on the sale of a home the first week in April 1980 under VA terms involving a $100,000 loan. I think you have copies or there is a copy up there.

VA permanent loan points were 8 at that time on a loan that would carry a 13-percent mortgage rate. That was $8,000. Our construction period interest at that time was 20 percent, which we have estimated in our budgets, which is the budgeting system that I've used for the last 15 years, $6,000 estimated holding period interest, just 3 months, $4,998. Construction loan points to get the construction loan were $1,000.

Under present conditions, those costs total $19,998. Now, under normal conditions, which are actual September of 1979, when I purchased one of the houses in my own subdivision, VA points were 2 with a 10-percent rate, $2,000. Now this is just 6 months ago, not 10 years ago. Construction period interest was 13½ percent at that time, or $3,937. Estimated holding period interest was 13½ percent, 3 months again, at $3,375. Construction loan points were $1,000 again.

The total 6 months ago of those costs was $10,312. The difference is $9,587. This constitutes a 93.9 percent increase in our interest costs alone. There is no subcontractor out there that comes anywhere near that inflationary figure.

Twenty-percent interest is inflationary. It also should be labeled criminal, either that or we are legalizing loan-sharking. The construction industry has been under these recessionary pressures, as was mentioned before, since last October, and many builders cannot withstand it much longer. It will be a matter of months before the bottom falls out. I see signs of it every day. These interest rates have lost the spring of 1980 market already. It is gone and no prospects can be seen so far for the summer markets.

I can say this because it appears to me no one has any control over this current situation. Nobody could tell me, that I called last month, if Congress or the administration was doing anything presently to prevent the construction industry from going into collapse.

This is not the first time the Federal Reserve or the President have been told of our problems. Why they haven't acted is beyond good economic judgment, which is sorely lacking today.

One builder the other day told me that, like Iran, the housing industry already was on economic sanction, although it has been longer for us. As you know, the mood out there is bitter. If our industry could be looked upon as four Chryslers, maybe it might be allowed to save itself. No subsidy, just save itself.

What has to be done? Well, No. 1, high interest rates are like high oil prices. They affect us all, except we have the power to control interest rates. Our thrift institutions cannot compete with Treasury bills at today's level and make mortgage loans at an affordable rate. Ceilings must be placed upon Treasury borrowing.

Congressman Archer has introduced H.R. 6907, which offers the industry a bill to create a flow of mortgage funds at an affordable rate by making available to thrift institutions the opportunity to offer insured certificates of deposit earmarked for mortgages at a low interest rate, let's say 7½ percent, on which the interest would be tax free to the depositor. This would make it competitive with money market certificates of 15 percent if he were a taxpayer in the 50-percent tax bracket.

But without this low cost inflow to thrift institutions, no mortgage funds would exist at an affordable rate. The Federal Reserve must change its policy and encourage productivity and growth. How can the money supply be growing if housing starts are at a level of post-World War II production? Obviously, demands for loans are not coming from the housing industry.

No. 3, the Federal budget must be balanced every year by legislative action. However, looking at this year, with the prospect—and I say the prospect—of 1.4 million jobs being lost in the construction industry, which constitutes $24.6 billion in wages being lost, with the potential $6.7 billion in tax revenues being lost, I don't see anyone balancing this year's budget.

The rollover mortgage is difficult to sell to purchasers. It may be what the thrift institutions want, but it's not what the public will accept at the present time. Inflation must be brought under control. Builders are the victims, and I say the victims, not the cause, of inflation.

Granted, some of our costs are locked in. However, many are not covered more than 30 to 60 days. When we give out a price on a home, 6 months later when we deliver that house inflation can eat into our costs worse than you think. I have yet to see anybody buy a house on a cost-plus basis. We have to give out a fixed price and we're stuck with that price.

Local governments must reduce availability fees and other superfluous charges. Utility availability fees alone in Fairfax County cost $2,475. Nothing is done for that money at all. When a water bill—and a copy of it is up there to you—70 cents worth of water usage totals $26.02. Then it starts becoming ridiculous.

The future outlook will depend upon one word, which was mentioned before—stability. There must be stability in every aspect of the economy. We must have a commitment to stability.

What we are going through presently, where builders can't build, farmers can't plant, lenders can't loan, the whole country can't perform its business, it is idiotic. At no period in our economic past have things been this bad.

Now, I would like to thank you again for the opportunity to speak to you. I still don't have any questions—excuse me, answers to my questions. I don't need the rhetoric I've been getting, but I would like a few answers. And I thank you very much.

Senator BENTSEN. Thank you, Mr. Stephens. We appreciate your statement.

And now I would like to call on the Chairman of the Federal Home Loan Bank Board, the Honorable Jay Janis.

STATEMENT OF HON. JAY JANIS, CHAIRMAN, FEDERAL HOME LOAN BANK BOARD, WASHINGTON, D.C.

Mr. JANIS. Thank you, Mr. Chairman and members of the committee. I am pleased to appear before you today to provide the views of the Federal Home Loan Bank Board on the outlook for housing and savings and loan associations in 1980.

I have a lengthy prepared statement for the record, Mr. Chairman, that I would like to summarize.

Senator BENTSEN. It will be printed in the record in its entirety.

Mr. JANIS. With regard to the recent state of the housing and financial markets, through most of 1979, a number of factors continued to support housing activity despite higher interest rates. These included: The favorable demographic population factors; the so-called investment psychology which made households less sensitive to mortgage interest rates and more willing to spend a higher percentage of income on housing expenses; a steadier savings flow through thrift institutions because of market-oriented—market-rate-oriented—certificates; a more highly developed secondary market; and substantial support provided by HUD subsidy programs. This was the picture through most of 1979.

However, the high and persistent rate of inflation eventually proved to be inimical to housing.

The Federal Reserve's action of October 6, in reaction to inflation, shifted the focus of monetary policy to holding down the growth in bank reserves. This caused interest rates to escalate sharply.

A further escalation in long-term interest rates occurred in the early part of 1980, as financial markets adjusted to expectations of continued high rates of inflation. At the same time, the Fed raised the discount rate to 13 percent on February 15, following a sharp rise in the inflation rate. And then on March 14, President Carter unveiled a new anti-inflation program that recognized the latter developments and took account of the need for a more restrictive fiscal policy and limited selective credit controls in order to produce a stronger and more balanced anti-inflation program.

The result of the actions taken since October 6 has been to increase the mortgage loan commitment rate nationally from a level of about 11½ percent in early October to a range that appears currently to be in the 15–17 percent interest rate, as the chairman has noted earlier. This unprecedented increase in mortgage rates has finally shut down the demand for mortgage loans to a substantial extent.

As a result of time lags, the above financial developments have still not fully affected housing starts. They have not affected them up until, perhaps, the figures that we have seen today for March, and I think this shows the full effect of these actions.

Housing starts have been coming down in a series of steps. By February, housing starts were down to a seasonally adjusted rate of 1.33 million. And, of course, for March, as the chairman noted, the Census Bureau just announced a sharp decline to 1.04 million units, just about 1 million units.

As might be expected, sales of new and existing homes have fallen increasingly below 1979 levels. New-home sales were down to a seasonally adjusted annual rate of 532,000 units in February, compared to about 817,000 units in 1978. We don't have the March figures as yet.

Existing-home sales, which has a very important relationship to housing starts, were down to a seasonally adjusted annual rate of slightly under 3 million units in February, compared to a peak rate of about 4 million units in September 1979.

No one is happy about this state of affairs. In the Bank Board's view, however, reducing inflation is the best way to bring down the interest rates and to meet this Nation's housing needs over the longer run. The very recent decline in interest rates is heartening, although it is obviously too early to say with any kind of certainty whether interest rates have actually peaked and are on their way down.

With regard to the sources and uses of funds for S. & L.'s in 1980, the so-called revolution in liability management of S. & L.'s through the use of market rate-oriented certificates will continue to reduce the risks of disintermediation. Nonetheless, we expect poor savings flows this year, especially during the first half. Savings flows, including interest credit, are estimated at $8 billion or less during the first quarter of this year, and that compares to $15.6 billion in the first quarter of last year. We expect even weaker savings flows this quarter. Under our assumptions, the net savings gains of S. & L.'s in 1980 should drop to $27 billion, from $38 billion experienced in 1978, from $50 billion in 1977.

So, therefore, we expect S. & L. mortgage lending to decline to about $57 billion this year, from almost $100 billion last year—and most of the decline is taking place in the first half of this year. I am talking now about mortgage lending activities of S. & L.'s.

With regard to the housing outlook for the coming year, we expect housing starts to average around 1 million units, or even lower, compared to the 1.75 million units of 1979. Even this low forecast assumes that larger builders will finds ways of financing housing sales through creative techniques on their part. Otherwise, starts would be even lower.

Let me say a word, if I might, about the financial viability of the savings and loan associations. The earnings situation of the S. & L.'s is largely a function of the fact that S. & L.'s at the beginning of March had 41 percent of their savings in high cost, short-term money, and this percentage is continuing to rise. The rollover of these high-cost savings instruments at the interest rates that have been prevailing in recent months——

Senator BENTSEN. Mr. Janis, this exodus of members has nothing to do with you. It is a vote that is taking place on the floor of the House.

Mr. JANIS. Thank you, sir. I will try to summarize.

Senator BENTSEN. You go right ahead, because what you are saying is terribly interesting.

Mr. JANIS. The rollover of these high cost savings instruments at these interest rates that has been prevailing in recent months has had quite an adverse impact upon the savings and loans.

Now, what do we expect for the S. & L.'s in 1980? We think that the rate of return on assets for S. & L.'s should be significantly lower than the 0.67 of 1-percent average for 1979, and possibly the earnings will be negative for S. & L.'s in the first half of the year, despite some further above-average nonrecurring penalty income. This reflects not only the sharply rising cost of funds, but the fact that lending activity which generates loan-orientation fees, is off sharply from last year. For the second half of 1980, we should have a significant negative rate of return on assets.

Now, what does this imply for the safety and soundness of the savings and loan industry? It seems to me that, unless interest rates remain high well beyond 1980, most S. & L.'s will be able to absorb this operating loss. Operating losses this year should not exceed 10 percent of the reserves of the industry—total reserves of the industry—even under very pessimistic assumptions. But we are obviously concerned about the impact on some individual S. & L.'s, and the fact that negative earnings cause S. & L.'s to be reluctant to make mortgage loans at interest rates that imply a negative spread over the cost of funds.

With regard to our own policies and the role of the Bank Board, we have taken a number of steps. For one thing, we worked with the other regulators in authorizing a new variable rate 2½-year U.S. Government certificate. Despite a 12-percent rate cap placed upon these certificates effective March 1, they continue to attract funds.

Our central bank system, the Federal Home Loan Bank System continues to provide advances—in other words loans—in substantial volume to its member institutions. We expect advances to be up by about $6.6 billion during the first half of this year. Our affiliated Federal Home Loan Mortgage Corporation, FHLMC, continues to maintain its presence very heavily in the mortgage market.

And on April 3, the Bank Board announced an important program to mitigate the earnings and net-worth problems that many S. & L.'s will face this year and to put them in a better position to resume mortgage lending on a large scale when interest rates subside. It consists of a three-part $630 million program designed to lessen the earnings squeeze of the S. & L.'s.

The first part of it had to do with a special dividend program to all S. & L.'s for 1980. The second part of it had to do with the contribution that FHLMC made, of $50 million of dividends to holders of its stock which are the Federal Home Loan Banks, which, in turn, can be utilized to help finance the dividends to the member savings and loan associations.

And third, for associations in need of assistance, our district banks have established a targeted advances program which provides a subsidy of about 250 basis points, 2½ percent, on advances. That would be under the advance rate which is the rate at which members can borrow from the Bank System. And up to $100 million of the total pot that I mentioned before will be used to subsidize advances under this program.

Mr. Chairman, I have more summary. But at this point, I think, in the interest of time, let me conclude by saying that we are apprehensive about the near-term outlook for housing. Clearly, the March figures justify that apprehension. But we are hopeful that if inflation can be dealt with through current Federal policies, housing will benefit over the long run.

In the meantime, we are excited about the new world that lies ahead for thrifts because of recent legislation passed by Congress, and certain regulatory actions that I have noted above. And we expected that this will produce a positive effect for housing over the long run, especially given the very strong demographic and lifestyle factors that will affect the household rate in the decade of the 1980's.

Thank you, Mr. Chairman, for the opportunity of testifying before your committee.

Senator BENTSEN. Thank you, Mr. Janis.

We will be back to some questions, of course, on your statement. We appreciate your presence and what you have had to say.

[The prepared statement of Mr. Janis follows:]

PREPARED STATEMENT OF HON. JAY JANIS

I am pleased to appear before you today and provide the views of the Federal Home Loan Bank Board on the outlook for housing and savings and loan associations in 1980.

My testimony will deal with the following points:

1. The Recent State of the Housing and Financial Markets.
2. Sources and Uses of Funds for S. & L.'s for 1980.
3. The Housing Outlook for 1980.
4. Financial Viability of S. & L.'s.
5. The Role of Bank Board Policies.

RECENT STATE OF THE HOUSING AND FINANCIAL MARKETS

The state of the housing and financial markets was affected profoundly by the October 6 announcement by the Federal Reserve that it would put more emphasis on bank reserves than short-term interest rates in implementing monetary policy. Before the October announcement, a number of factors had supported housing activity despite the high interest rates in 1978. These included favorable demographic factors and the existence of an "investment psychology" arising out of expectations of inflation in the housing market. In addition, thrift institutions were better able to provide for steady savings flows despite rising interest rates, and, thus, stay in the mortgage market. This was the result of the use of money market certificates tied to the six month Treasury bill rate and of jumbo certificates. Through the use of market-rate oriented money, savings and loan associations avoided the disintermediation that has normally characterized high interest rate periods.

Other factors that supported housing activity prior to October 6 included the availability of additional mortgage funds due to a more highly developed secondary mortgage market than existed during past tight credit periods and the substantial support provided by HUD subsidy programs, primarily the Section 8 rental housing assistance program. Thus, through September, 1979, housing starts were maintained at a seasonally adjusted annual rate of 1.76 million units, representing a decline of 13 percent from the 2.02 million units started in 1978, which is a moderate decline considering the high level of interest rates and the sharply rising prices of homes.

The Fed's actions of October 6, changed the situation, however. The immediate impact of the Fed's announcement was to produce an upward escalation in interest rates. These rose across-the-board. In many places, mortgage interest rates rose to 13½ and 14 percent by the end of 1979 from a level of about 11½ percent before the Fed's actions. These sharply higher rates weakened the demand for mortgage loans appreciably. And in states with restrictive usury laws, the supply of mortgage funds dried up almost completely.

After the October 6 announcement, housing activity declined only moderately at first. Starts were maintained by loan commitments made previously when interest rates were lower and funds more plentiful. In October, housing starts declined to 1.71 million units. In November, starts finally fell sharply to a seasonally adjusted rate of 1.52 million units and remained close to this rate in December. For 1979 as a whole, 1.75 million units were started.

By January of this year, housing activity began to slide even further. Starts dropped in January to 1.42 million units and in February to 1.33 million units. The cause this time, unlike in the past three years, was not severe winter weather. In fact, housing starts, as reported, may even have overstated the strength in the housing market since seasonal adjustment factors in January and February reflected the abnormally severe weather conditions of earlier years. Housing starts for March will be released this afternoon, and I do not presently have this data.

As might be expected, sales of new and existing homes have fallen increasingly below 1979 levels. New home sales, which had been 817 thousand units in 1978 and averaged 733 thousand units during the first nine months of 1979, were down to a seasonally adjusted annual rate of 532 thousand units in February. Existing home sales were down to a seasonably adjusted annual rate of slightly under 3 million units in February compared to a peak rate of 3.9 million units in September 1979.

From the standpoint of housing markets, the most important development since the Fed's October 6 change in monetary policy was the unveiling of President Carter's new anti-inflation program on March 14. It should be noted that this action was preceded by sharply rising long-term interest rates in the early part of 1980 as financial markets adjusted to expectations of continued high rates of inflation. A further increase in the Federal Reserve discount rate to 13 percent on February 15 followed a sharp escalation in the inflation rate. The President's program recognized the latter developments and took account of the need for a more restrictive fiscal policy and the use of limited selective credit controls in order to produce a stronger and more balanced anti-inflation program.

Although the President and the Fed specifically excluded the housing industry from the selective credit controls, housing will continue to decline because of the further escalation in interest rates in recent months; and the very recent decline in interest rates still leaves rates at high levels. The six month T-bill rate rose above 15 percent briefly, and the prime lending rate reached a record high of 20 percent. Mortgage loan commitment rates have risen to a range of 15 to 17 percent and even higher. These high interest rates are producing another sharp drop-off in loan commitment activity and are weakening demand for mortgage money even further.

No one is happy about this state of affairs. Nevertheless, we must face the fact that Federal Reserve policy, in order to be effective, is going to have to exert a negative impact on housing. The President's new program may, hopefully, reduce upward pressure on interest rates in the next month or two and may have already done so based on very recent financial developments.

The Bank Board's concern is that housing not shoulder a disproportionate share of the burden of tight credit. And if housing production is too sharply affected—and for too long a time—the resulting short-fall in housing starts, because of the strong underlying demand for housing, will cause pressure on housing prices as soon as conditions return more or less to normal levels. As a result, the inflationary rebound in the economy, pushed by the housing sector, could become a serious problem in the next cycle.

In the Bank Board's view, however, reducing inflation is the best possible way to bring down interest rates and to meet this nation's housing needs over the long-run. That is why I support the Fed's monetary actions and the President's fiscal initiatives in the hope that these efforts will reduce the sustained need for these high interest rates and allow for the significant decline in interest rates that will ultimately help housing.

It now seems clear that the Fed's actions dating from October 6 merely accelerated something that probably would have happened anyway on a more gradual basis. Even without the Fed's dramatic steps of October 6 and those taken more recently, I believe we would have seen an upward creep in interest rates because of the underlying serious inflation problem. Nevertheless, the very rapidity with which interest rates escalated, first after October 6 and then again in the early months of this year, made it difficult for the housing market to absorb the increase. We hope that the sharp rise in interest rates will break the inflationary psychology that was itself feeding inflation and putting constant upward pressure on interest rates. If the financial markets can be convinced that present economic policy is going to bring down the rate of inflation, even if slowly, it could have a significant downward influence on interest rates. Furthermore, continuation by the Federal Reserve of its new operating strategy emphasizing reserve targets should lead to more downward flexibility in interest rates if and as the economy weakens. The shift to a projected budgetary surplus in fiscal 1981 and the limited selective credit controls should also help in the battle against inflation and bring down interest rates.

In our opinion, the adverse impact of high interest rates on thrift institutions and housing depends on how long tight credit persists. This issue of "duration" is crucial. For one thing, it affects those institutions' ability to provide support

for housing in the future and even threatens their financial integrity. For another, the duration of tight credit affects builders and their ability to withstand inactivity and still manage to survive.

SOURCES AND USES OF FUNDS FOR S. & L.'S FOR 1980

The revolution in liability management of S. & L.'s through the use of market rate-oriented certificates will continue to provide some support for the flow of savings. Nonetheless, the competition from money market funds and open market securities has become more keen as interest rates have risen and savers have become more sophisticated. In addition, S. & L.'s will probably be reducing their reliance on jumbo CDs, in part because of the extremely high interest rates, on these, now as high as 17 percent or more. Savings flows have already weakened this year. Thus, during the first quarter, savings flows, including interest credited, are estimated at $8.0 billion or less compared to $15.6 billion in the first quarter of last year. The first quarter traditionally is marked by a strong seasonal flow of savings. We expect even weaker savings flows this quarter, perhaps an outflow if interest credited is not included.

Obviously, the outlook for savings for 1980 as a whole depends upon our projections as to when interest rates, especially the 6 monthy T-bill rate, will peak. We hope that the various policy actions will lead to declining interest rates before long; and, as I have noted, interest rates have recently come down from their peaks. Nonetheless, any significant decline in interest rates will probably come too late to bolster savings flows and mortgage credit availability this year by a significant amount.

In light of our assumptions, we expect the net savings gain of S. & L.'s in 1980 to drop to $27.0 billion from the $38.8 billion experienced in 1978 and $50.2 billion in 1977. This drop translates into a sharp decline in the number of housing units that can be financed by S. & L.'s.

Like savings flows, loan repayments—the other major internal source of S. & L.'s funds—are expected to decline sharply as existing home sales slow down further in response to high mortgage interest rates. Loan repayments could decline to about $40 billion in 1980 compared to $50 billion in 1979.

Based on these projected internal sources of funds, we expect S. & L. mortgage lending to decline to about $57 billion from $99.6 billion in 1979. Most of the decline is taking place in the first half of this year. By the second half of the year, lending may increase slightly, but we expect that the general weakness in the economy likely to prevail then will keep demand for housing weak. Nonetheless, because of the strong underlying demand for housing, a rebound in housing should occur by either the closing months of this year or by early next year.

Given the situation just described, there has been a strong demand for external sources of funds by S. & L.'s so far in the first half of this year. The Bank System expects to provide an additional $6.6 billion in advances during this period. This demand for external funds reflects the need to fund withdrawals of traditional savings accounts, a reduction in the use of jumbo CDs, and the need to finance outstanding mortgage loan commitments. During the second half of this year, we expect that S. & L.'s are more likely to be repaying advances, a typical pattern during the later stages of a decline in housing activity. However, our recently announced targeted advances program and uncertainty about future interest rates could possibly result in some rise in advances for awhile after mid-year.

HOUSING OUTLOOK FOR 1980

The outlook for housing in 1980 has deteriorated in the face of anti-inflationary policies. What needs to be emphasized is that the financial environment has been unfavorable for housing at least since October 6 and has deteriorated even further in recent months. We presently expect that housing starts in 1980 will average between 1 and 1.1 million units this year compared to 1.75 million units during 1979. Even this low forecast assumes that builders will have to rely on creative techniques for financing housing or else housing starts would be even lower. In addition, shipments of mobile homes, which are a major source of low cost housing, will probably be down to 225 thousand units or lower this year compared to 277 thousand units last year.

We expect the decline in conventional type housing to occur in both single-family and multi-family units. Earlier, we had anticipated that Federally-subsidized programs—especially Section 8—would keep multi-family housing starts from declining substantially. It is becoming increasingly apparent that even some Section 8 projects may have to be deferred at current interest rates. In the unsubsidized rental market, low profit margins have depressed starts for some time. Also, the lengthy period of construction necessary for multi-family units further discourages building because of the high interest rate on construction loans, generally the prime rate plus an add-on. Finally, the multi-family condominium market probably will be depressed for the same reasons as single-family units.

We expect that single-family starts will slump to 680 thousand units for 1980 as a whole compared to 1.17 million starts in 1979. Multi-family starts (defined as starts in structures with 2 or more units) may decline to 380 thousand units compared to 550 thousand units in 1979. Here, I would like to take the opportunity to support strongly the President's request for 300 thousand subsidized housing units in fiscal year 1981. If we are to meet our national commitment in this area, it is essential that Congress fund this request fully.

With respect to the time pattern of housing activity this year, we expect that the trough of housing starts is likely to be about 900 thousand units on a seasonally adjusted annual basis in the third quarter of this year. Because of the time lags involved in the housing market process, the trough could occur even as late as the fourth quarter. The exact figure for any projected trough is highly uncertain since we have no historical experience with respect to the impact of existing interest rates on housing starts. However, if a peaking in interest rates has already occurred, a moderate rebound in housing starts should be underway by the fourth quarter.

An important factor in the housing outlook is that thrifts are putting most of their reduced volume of new funds into high interest rate short-term assets rather than mortgages. The earnings squeeze on S. & L.'s, which I discuss below, makes them highly reluctant to continue utilizing high cost advances, other borrowings and jumbo CDs to finance mortgage expansion. They also view it as extremely risky to use short-term high interest rate funds as a source of money for mortgage lending.

Because builders have remained conservative in their inventory policies, and the rental vacancy rate is at a historic low, we expect that housing starts may rebound much more sharply if and as credit conditions ease than during similar previous periods. Underlying housing demand should also remain strong through the 1980's. If inflation is reduced at a reasonable pace and Federal support for subsidized housing continues, there is no reason for starts not to exceed 2 million units per year for the rest of the decade. And to this we can add perhaps an average of 300 thousand or more mobile homes per year.

FINANCIAL VIABILITY OF S. & L.'S

As I have already indicated, the revolution in liability management of thrift institutions had the salutary impact of supporting both savings flows and the level of housing starts through most of 1979. However, the result of issuing market rate-oriented certificates is that a large percentage of funds now in thrifts are in very high cost short-term money—about 41 percent of the savings of S. & L.'s as of the end of March, although the percentage varies regionally. Thus, thrifts are in a highly leveraged position. The rollover of these high cost liability instruments at higher interest rates of recent months is having quite an adverse impact on S. & L. earnings for the time being. If and when short-term interest rates begin to decline significantly, thrift earnings would improve. But it will take a significant and sustained decline in interest rates to produce a reasonable rate of return on assets for S. & L.'s.

Let me comment on the earnings outlook for S. & L.'s. During 1978 the rate of return on S. & L. assets average .82 of 1 percent, the highest in many years. For the first half of 1979, this rate was .69 of 1 percent, which, while down from 1978, was about the average rate of return for the decade. During the second half of 1979, the rate of return on assets was .65 of 1 percent. The figure for the second half would have been lower except for the nonrecurring effects of income received from early withdrawal penalties. We expect the figure for the first half of 1980 to be significantly lower despite some further above average non-recurring penalty income in recent months. The low figure for the first half of 1980 should reflect not only the rising cost of funds but the fact that lending activity, which generates loan origination income, is off sharply from levels of last year.

We recognize that, with short-term interest rates at high levels, S. & L.'s as a whole will experience a negative rate of return on assets for the year and an especially significant negative rate of return in the second half. Fortunately, most of the S. & L.'s that will suffer poor earnings experience have an adequate net worth cushion. Unless interest rates remain high well beyond 1980, most S. & L.'s will be able to absorb these losses without a significant reduction in their ability to remain viable competitors. Problems, however, could arise for S. & L.'s that lack an adequate net worth and reserve cushion. As a result, the Bank Board has proposed that the present FIR requirement be replaced by a reserve requirement that would permit operating losses to be absorbed by total net worth rather than merely that part of the net worth that is not required FIR. Reserve requirements would be reduced for many S. & L.'s under this proposed regulation since they would be based on beginning-of-year rather than end-of-year deposits.

S. & L.'s have been encountering a "no-win" situation in the recent economic environment, with liabilities becoming more sensitive to market rates of interest while their mortgage investments remain largely long-term at fixed rates. Although we would prefer less reliance on high cost short-term liabilities, the two alternatives to this dependence are unattractive. One course would be for the S. & L. industry essentially to go out of the mortgage lending business for a substantial period of time and to do nothing except honor savings withdrawal requests and originate loans for others. This course would cause housing production to drop even further and the S. & L. industry would shrink in size. The other alternative would be to authorize much higher interest rates on long-term certificates. While this would keep S. & L.'s in the mortgage market longer, it would lock them into a very high cost of funds for a prolonged period of time and make profitable operation difficult without an extremely high floor for mortgage interest rates for many years. As I shall shortly note, the Bank Board expects the newly authorized renegotiated rate mortgage to provide eventually the needed rate flexibility on the asset side to match the rate flexibility that now exists on the liability side.

THE ROLE OF BANK BOARD POLICIES

The Bank Board and the FHLBank System have taken many measures designed to keep money flowing into S. & L.'s despite high interest rates. In January of this year, a new variable rate certificate carrying an interest rate tied to that of 2½ year U.S. Government securities was introduced. Despite a 12-percent rate cap placed on these certificates effective March 1, they continue to attract funds.

Recent Bank Board regulatory actions have enabled associations to tap nontraditional sources of funds through the use of commercial paper and Eurodollar certificates. In addition, the Bank System has continued to provide advances in substantial volume to its member institutions as a source of housing credit The Bank Board also continues to provide support for housing through the secondary market purchases of our affiliated Federal Home Loan Mortgage Corporation. The Mortgage Corporation has the capacity to make mortgage commitments of $9 billion this year, although the adverse impact of high interest rates will hold down the volume of commitments well below this level. Nonetheless, the Corporation continues to maintain an important presence in the mortgage market.

On April 3, the Bank Board announced a very important program to mitigate the earnings and net worth problem that many S. & L.'s will face this year and to put them in a better position to resume mortgage lending on a large scale when interest rates subside. It consists of a 3-part program designed to bolster earnings of S. & L.'s by $630 million. First, beginning with the second quarter of 1980, dividends on stock held in the District Banks will be paid to member institutions quarterly instead of merely at year-end. Second, the Mortgage Corporation will pay a $50 million dividend to the holders of its stock, the Federal Home Loan Banks, which will in turn utilize this to help finance dividends for member institutions. And, third, for associations most in need of assistance, the District Banks have established a targeted advances program (TAP) which provides a subsidy of about 250 basis points on advances. Up to $100 million will be used to subsidize advances under this program.

Effective Appril 1, the Board also lowered the liquidity requirement to 5 percent from 5½ percent. This most recent action should provide more asset flexibility for S. &. L.'s. Also, the Bank Board has proposed an increase in the ability of Federal associations to engage in outside borrowing, i.e., borrowings from sources other than the Bank System itself. The present limit of 10 percent of savings (with an additional 5 percent for conforming mortgage-backed bonds) would be raised under the proposal to an overall limit of 20 percent of assets. Once we have completed analyzing the comments on the proposal, further liberalization may appear appropriate. Unfortunately, this will be of little assistance in the near-term because of the level of interest rates.

In attempting to cope with the problems of thrifts and housing today, the Bank Board is somewhat frustrated. There is an outside world that constrains the Bank Board almost as much as it constrains thrifts. In today's world, much competition to thrifts is coming from open market obligations and money market obligations and money market funds, not merely commercial banks. In addition, most thrifts face increasingly sophisticated savers. Perhaps the more accurate term for savers now is investors. They feel just as squeezed as thrifts in this inflationary environment. They do not want to accept negative real returns on their financial assets.

Any improvement in the outlook for thrifts, just as for housing, depends upon bringing down the rate of inflation. Unless this occurs, any financial strategies that thrifts pursue and any policies that the Bank Board follows can only moderate the financial problems of thrifts. But it can't cure them. Many S. & L.'s have written the Bank Board asking for a cap on 6 month MMC's to reduce their escalating cost of funds although the industry is not united on this. But with over $150 billion in MMC's rolling over every six months, even a moderate attrition in such MMC's because of a cap would impose a demand for advances that the Bank System could not meet.

What happens if interest rates have not peaked and operating losses of S. & L.'s become widespread? Supervisory agents can waive restrictions for not meeting reserve and net worth requirements; and the Bank Board has the tools to reduce such requirements within limits. Nonetheless, there is some level of capital that S. & L.'s need for their own protection as well as for the protection of the public and the FSLIC. The Bank Board hopes to take actions this year to revamp reserve and net worth requirements. The proposed regulation I mentioned above is just the first step.

Some mergers, whether FSLIC-assisted or not, will undoubtedly occur in response to S. & L. financial problems. Yet mergers are only a limited solution because all S. & L.'s are being affected adversely to some degree by the unfavorable financial climate.

This brings me to the momentous changes in store for the S. & L. industry as a result of the (1) Proxmire-Reuss Depository Institutions Deregulation and Monetary Control Act that has been signed by President Carter and (2) authorization of renegotiable rate mortgages for Federal S. & L.'s by the Bank Board.

The Deregulation Act phases out Reg. Q. However, much of the Reg. Q issue was largely disposed of before the passage of the Deregulation Act and its mandated six year phase-out of rate control. With all new thrift money already in the form of market rate-oriented certificates, the phasing out of rate ceilings has already occurred to a large degree.

Thus, the S. & L. industry is already in the midst of a revolution in orientation. Now, this revolution—already having occurred to a large extent on the liability side—has been broadened and formalized through the Deregulation Act. The Act provides for NOW accounts next year. It also provides 20 percent lending authority for consumer loans, commercial paper, and corporate bond authority, increased service corporation activity, credit card authority on an unsecured basis, and expanded real estate lending powers that do away with geographic lending limits and mortgage amount ceilings and permits second mortgages as a conforming type of loan.

Perhaps most important is Federal preemption of usury ceilings on mortgage loans if not overriden by states within three years—a provision that is absolutely vital if standard fixed-rate mortgages are to be always available and if VRMs and RRMs are to be workable. And, in this environment, where people are becoming concerned about a safe haven for their funds, the increase in FSLIC insurance of accounts to $100,000 should be very helpful. Many of the above powers have already been implemented by regulation by the Bank Board. The others should be acted upon soon. With respect to using the new flexible authority to vary reserve requirements from 3 to 6 percent, the Board is deferring action until it deals with the more fundamental issue of whether a risk-based index is desirable and feasible.

What does this all add up to for the future direction of the S. & L. industry? This permits them to become family finance centers and offer a full cluster of services to consumers, a concept on which the industry has been divided. Realistically, consumer lending is not profitable now because of the high cost of money, low usury ceilings on consumer credit in many states, and the Federal Reserve's selective credit control program. But, over the long-run, S. & L.'s will have to offer consumer loans, especially overdraft privileges with NOW accounts. As EFT becomes more important, overdraft privileges will be an essential competitive tool even if this does not appear profitable now. S. & L.'s should not make the mistake of viewing each new power separately and worrying about the headaches and startup losses involved with each. They should look at all the powers as a total service package and face the fact that offering them all should make it easier to attract savings. Nor should such powers be viewed in a short-run context. These powers will not do much, if anything, for thrifts over the next few years. They will not solve their current financial problems and were not designed to do so. But, viewed over the longer run, S. & L.'s will find them essential to compete for savings accounts in a non-rate control environment.

But it is the renegotiable rate mortgage that, over the long run, will end up being the most important salvation of the S. & L. business and of the housing credit market. It will take some years to convert a meaningful part of S&L portfolios to RRMs, and many S. & L.'s may decide that it is to their benefit to continue offering fixed-rate long-term mortgages. The RRM will provide the needed variability in yield on the asset side to balance the variability in yield on the liability side. It will help deal with the risks inherent in borrowing short and lending long.

Over the longer-run, the policy actions taken to assist thrifts and to bring about reduction in the inflation rate will help housing very much. But it is only realistic to expect that housing activity will be low this year before rebounding to levels necessary to meet long-run demands.

Senator BENTSEN. Our next witness is the Honorable J. Charles Partee, distinguished member of the Board of Governors of the Federal Reserve Board.

Mr. Partee.

STATEMENT OF HON. J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, WASHINGTON, D.C.

Mr. PARTEE. Thank you, Senator Bentsen.

I am pleased to appear today on behalf of the Federal Reserve Board, Senator, to discuss the subject of housing and the economy. This is an appropriate and timely focus of inquiry. Problems in housing often are considered in isolation from the rest of the economic system. Though that is at times the relevant focus, under current circumstances it seems to me important that the short-term situation of housing and housing finance be evaluated in the light of overall economic activity and national policy objectives.

Conditions in the mortgage and housing markets have deteriorated sharply in recent months and residential construction activity now seems likely to decline to relatively low levels for much or all of the remainder of this year. Most of the decline, of course, has occurred since last October when the Federal Reserve announced a number of important policy changes. That package of measures was designed to give the Federal Reserve better control over aggregate flows of money and credit, and the further actions taken in mid-March are intended to reinforce the credit restraining aspects of that effort. Up until now, unfortunately, overall credit demands have remained exceedingly strong, reflecting the persistent strength of inflation and widespread inflationary psychology as well as a continuing high level of aggregate economic activity. With strong credit demands pressing against limited supplies, financial markets have tightened substantially, interest rates have risen sharply, and housing starts and home sales have plummeted.

The overriding objective of recent Federal Reserve policy actions has been to reduce inflationary pressures in the economy—pressures that have intensified steadily over the past year. Inflation weakens the value of the dollar at home and abroad, diverts attention from productive to nonproductive pursuits, and inevitably creates a host of economic and social distortions, imbalances, and inequities. Indeed, mortgage and housing markets have not been free of a pattern of speculative and anticipatory behavior that could threaten seriously destabilizing consequences over the longer term if inflation and inflationary expectations are not restrained. The Board believes that the long-run benefits to be derived from containing inflation will far outweigh the short-run costs incurred in housing and other markets.

Inflation has produced serious problems also for the nonbank thrift institutions and for other types of investors that concentrate their holdings in longer term instruments bearing fixed interest rates. With the increase in actual and expected inflation rates, nominal interest rates have risen apace as lenders have sought to protect the purchasing power of their dollars and borrowers have been willing to pay higher inflation premiums. Consequently, high-quality loans, made in the past at the lower interest rates of the time, have become burdens for institutions that had followed prudent business practices and provided the useful service of maturity intermediation—borrowing short-term from savers and making long-term funds available to borrowers. Savings inflows to these institutions have slowed markedly, even though the average effective rate paid for funds has moved substantially higher, so that the interest and participation of such institutions in the mortgage market has been on the decline.

The effects of inflation have not been restricted to the supply side of the mortgage markets. The inflationary process clearly has influenced the behavior of home buyers and mortgage debtors also, causing some distortions within this market and affecting patterns of household savings and investment. High rates of inflation, in conjunction with the tax system, have enhanced the appeal of homeownership, made rental housing less attractive to investors, and stimulated the conversion of rental projects to condominium ownership status—creating hardships for some tenants. The strong demands for homes have pulled house prices up at a pace that, until recently, was well above the increase in broad-based price indexes, making it increasingly difficult for new entrants to achieve homeownership. And since many homeowners apparently have viewed unrealized capital gains as an important supplement to their wealth, they have been inclined to consume larger proportions of disposable personal income, incur larger debts, and accept less liquid balance sheet positions.

The demand for home mortgage credit remained historically quite strong until late last year, despite the fact that mortgage interest rates had risen to postwar highs. Prospective capital gains on homes and expectations of rising nominal income encouraged buyers to commit unusually large shares of their current income to mortgage payments. Since last October, however, mortgage credit demand has weakened as mortgage rates have risen sharply further and the availability of credit has become constrained. Indeed, many prospective buyers have been unable to meet more stringent lender standards concerning acceptable ratios of mortgage payments to borrower income.

The effects of general monetary restraint customarily fall quite heavily on the mortgage and housing markets, and the Federal Reserve Board has consistently supported and recommended measures that would spread the burden of credit restraint more evenly throughout the economy. For example, it makes good sense to remove artificial interest rate constraints on the flow of mortgage funds and to free gradually local depository institutions from the interest rate ceilings that prevent them from competing in the markets for savings. Institutional adjustments designed to permit mortgage borrowers to compete more effectively for funds with other participants in the long-term debt markets also seem highly desirable. Mortgage passthrough securities have been a particularly important innovation, providing a way for home buyers indirectly to raise mortgage funds on reasonably favorable terms in the national capital markets. Local lenders also have obtained funding from the impersonal national markets for large CD's and commercial paper far more than before, while continuing their active use of traditional nondeposit sources—primarily Federal Home Loan Bank advances and sales of mortgages in the secondary market to FNMA and others.

The nonbank thrift institutions, of course, cannot be insulated from the effects of rising market interest rates. Earnings on thrift portfolios have not risen in line with market rates because of the preponderance of long-term fixed-rate assets acquired in past periods. Recent experience has clearly demonstrated the need for more variable yields on assets held. If the thrift institutions are to continue their emphasis on mortgage financing, that attribute of rate flexibility will be required more commonly in the mortgage instrument as well. The Federal Reserve has long supported the expanded use of variable-rate mortgages, with appropriate consumer safeguards, and has endorsed the Bank Board's authorization of renegotiable-rate or "rollover" mortgages for use by the savings and loans. The need for these types of mortgage instruments is even more pressing now that Congress has legislated a phaseout of deposit rate ceilings.

Meanwhile, we at the Board are acutely aware of the recent drying up in mortgage money. In designing the special credit restraint program announced March 14, banks were asked to give priority attention to maintaining a reasonable availability of funds to small businesses, such as local builders, and to serving the liquidity needs of their thrift institution customers. The special deposit requirements placed on increases in consumer credit specifically exclude from coverage credit that is extended for the purchase or improvement of homes. Finally, the special deposit requirements imposed on any further expansion in the assets of money market mutual funds should help limit the massive recent movement of savings toward the central money market, thus leaving more funds available in local markets to help meet local credit demands, including those associated with housing.

Nevertheless, with mortgage interest rates at their current extraordinary level, it seems clear that many prospective borrowers will defer home purchases and remain in their present accommodations until conditions become more favorable. Mortgage lenders and homebuilders, correspondingly, will experience considerably reduced levels of activity. This situation is likely to be relatively short lived, however. and it is well to remember that these industries have often before demonstrated their ability to snap back after periods of tight credit.

The Congress may wish, of course, to consider special programs to aid housing through this current difficult period. In any such consideration, we would urge that the benefits expected from specific measures be carefully weighed against the likely costs. The types of programs used in the last housing downswing to provide mortgage credit to home buyers at below-market interest rates undoubtedly would provide some support for housing activity in the short run. On the other hand, Federal borrowing to finance these programs would tend to put further upward pressure on market interest rates and could thereby intensify the problems being experienced by the thrift institutions. Use of special subsidy programs, moreover, would add to budgetary and/or Federal credit program outlays and would logically call for offsetting cutbacks in other areas if the discipline of holding back on Federal expenditures as a part of the inflation fight is to be maintained.

In any event, short-run solutions designed to aid the mortgage and housing markets will not go to the core of the problem facing these and other sectors of the economy. In order to obtain lasting improvement, the inflationary process must be halted. As inflation abates and inflationary expectations dissipate, market interest rates will recede and pressures on the depository institutions will ease. The Federal Reserve role in assisting this process must be to restrain growth in money and credit to rates consistent with the longer run needs of the economy. Our success in holding to this course, I believe, will constitute the best hope for restoration of stable, viable housing and residential mortgage markets that will serve the growing needs of our population.

Thank you, sir.

Senator BENTSEN. Thank you very much, Mr. Partee.

Our next witness is Jack Carlson, executive vice president and chief economist of the National Association of Realtors.

STATEMENT OF JACK CARLSON, EXECUTIVE VICE PRESIDENT AND CHIEF ECONOMIST, NATIONAL ASSOCIATION OF REALTORS, CHICAGO, ILL.

Mr. CARLSON. Thank you, Mr. Chairman. Housing is being hurt now more than at any time in the last 35 years. Existing home sales are down by one-third since last fall. The conditions in the housing industry are equivalent to an unemployment rate of 33 percent, and a loss of income of one-third from an average annual income for real estate people of about $20,000 last fall to $13,000 now.

Moreover, we can expect even worse conditions during the second quarter of this year. If this decline were extended to the entire economy, the collapse is greater than occurred in the Great Depression in the 1930's.

Housing starts are down by 40 percent since last fall and are likely to decline even further, even below the 1 million current level we see now, creating unemployment in housing construction equivalent to 40 percent after correcting for underemployment.

Construction of rental housing is at a very low level and can be expected to cause even a greater shortage of rental housing nationwide.

Housing has been hurt badly because of soaring short-term and long-term interest rates. Mortgage rates have increased from 11 percent to 15 percent during the last year causing monthly payments of principal and interest on the typical mortgage to increase by over 54 percent, from $393 to $607, from 19 percent to 26 percent of median disposable household income.

This greatly limits homeowners' ability to purchase a first home and existing homeowners' ability to sell existing homes with the lower payments for principal and interest in order to purchase another more adequate home with much higher payments for principle and interest.

Short-term interest rates for constructing new homes have increased from about 14 percent to 22 percent. Financing costs for the median-priced home have increased since last year from 8-to-12 percent of the cost of a new home at the time of sale to 15-to-20 percent, as much as doubling the financing costs for the average builder as indicated by builder Mike Stephens.

And this, of course, must be borne by the future homeowner. Understandably, prospective homeowners are hesitant to absorb higher construction cost, and builders are reluctant to accept the much higher risk.

Since 1976, over half of the acceleration of inflation which has caused record interest rates and the collapse of the housing industry is attributable to Federal Government policies. One-third of the acceleration of inflation since 1976 was caused by increases in OPEC prices; 100 million workers and business people are not the major cause of accelerating inflation. Compensation per man-hour has lagged behind inflation. Profit margins from current production have declined. The most recent response by the Federal Government to higher inflation and interest rates is to propose even higher inflation and higher interest rates during the next 6 months than would otherwise occur. And then to promise to fight inflation after 6 months in the next fiscal year, which is after the November election.

The President advertised spending cuts of $2 billion, but failed to advertise spending increases of $6 billion, or a net increase in Federal deficit spending of $4 billion for fiscal year 1980.

The House and Senate Budget Committees are essentially endorsing the President's lead. The President's proposed credit policies have caused interest rates to be higher than otherwise and further hurt housing. The President is imposing an import fee that will drive up gasoline prices enough to cause about one-half of 1 percent increase in overall consumer prices in the short run, and 2 percent higher consumer prices in the longer run after adjustment in competing fuels and cost-of-living adjustments occur.

To add insult to injury, the Government has increased wage and price regulations as a political way to shift blame to workers and business people and away from the Federal Government.

Thus, the housing industry and other people adversely affected by higher interest rates and higher inflation now are left with even more harmful Government policies during the next 6 months.

The President and the House and Senate Budget Committees promised to repent next year after the election, and then only to promise slow spending growth very modestly.

However, Americans remember the promises last year at this time when both the President and the Congress in the first concurrent budget resolution promised less than an 8-percent growth in Federal spending which has now risen to over 15 percent. Promises with this track record and with no effort to fight inflation with fiscal policy now are not credible, and the stock and bond markets have told us so.

Government policymakers are saying that they will only add to inflation and not fight inflation with fiscal policy. Government policy will fight inflation only with soaring interest rates and reliance on a recession in the private sector and with huge increases in tax burdens, $900 increase per household in 1980 and a record $1,200 in 1981.

This sacrifice is made so the Federal Government can experience boom spending conditions. The situation is so perverse that recipients of Federal spending programs that do not require work are receiving a faster growth in income than the workers who pay the taxes for these programs.

Where people are eligible, the message is clear: It pays not to work. The Government's proposed increase in inflationary deficit spending for the remainder of this year and record increases in tax receipts for next year are contrary to the preferences of the majority of the people as indicated by recent Gallup surveys.

Thus, Government policies are contrary to the apparent will of the majority of the people. Improvements in Government policies to fight inflation, lower interest rates, and reverse the trend in housing need not be drastic and disruptive. Two percentage points' slower growth in spending during the next 18 months would reduce quarterly Federal deficits and achieve a balanced budget during 1981 and allow for tax relief to stimulate savings and investment beginning in 1981 and extend into subsequent years.

In particular, we recommend: Slow Federal spending by 2 percent or $6 billion during the remainder of 1980 so that spending totals no more than $563 billion. Slow spending by 2 percent or $17 billion during 1980 so that spending totals $595 billion. Achieve a balanced budget in 1981 by slowing spending, and not by increasing tax receipts higher than $595 billion.

Begin tax relief to encourage savings and investment in 1981 with larger tax relief in subsequent years. Maintain spending growth significantly less than the growth of people's income. Avoid additional wage, price, and credit controls. And phase out existing controls.

The modest 2-percent solution could significantly reverse the trend in inflation and interest rates during the next 90 days.

From the same psychological factors that Mr. Janis referred to, I feel that we can reduce producer prices by 3 to 5 percent from 20 to 15 percent, reduce inflation in consumer prices by as much as 3 percent from 18 to 15 percent, reduce some short-term interest rates by 5 percentage points from 22 to 17 percent for construction loans, reduce mortgage interest rates from 15-to-17 percent in that range now to an average of 14 percent and, of course, over the longer run, they could even have a more significant impact.

Thank you.

[The prepared statement of Mr. Carlson, together with attachments, follows:]

Prepared Statement of Jack Carlson

I am Jack Carlson, executive vice president and chief economist of the National Association of Realtors. On behalf of the 750,000 members of the national association, I wish to commend Chairman Bentsen and the committee for holding these hearings during these worst of times for the housing industry.

SUMMARY

Housing is being hurt more now than at any time during the last 35 years. Existing home sales are down by one-third since last fall. The conditions in the housing industry are equivalent to unemployment of 33 percent and loss of income of one-third—from an average annual income of real estate people of about $20,000 last fall to $13,000 now. Moreover, we can expect even worse conditions during the second quarter of this year. If this decline were extended to the entire economy, the collapse is greater than occurred in the Great Depression in the 1930's.

Housing starts are down by 30 percent since last fall and are likely to decline further, creating high unemployment in housing construction and supplying industries. Construction of rental housing is at a very low level and can be expected to cause even a greater shortage of rental housing nationwide.

Housing has been hurt badly because of soaring short-term and long-term interest rates. Mortgage rates have increased from 11 percent to 15 percent during the last year causing monthly payments of principal and interest on the typical mortgage to incrase by over 54 percent, from $393 to $607, from 19 percent to 26 percent of median disposable household income. This greatly limits homeowners' ability to purchase a first home, and existing homeowners' ability to sell existing homes with the lower payments for principal and interest in order to purchase another more adequate home with much higher payments for principal and interest.

Short-term interest rates for constructing new homes have increased from 14 percent to 22 percent. Financing costs for the median-priced home have increased since last year from 8 to 12 percent of the cost of a new home at the time of sale to 15 to 20 percent, as much as doubling financing costs for the average builder, which must be borne by the future homehowner. Understandably, prospective homeowners are hesitant to absorb the higher construction costs and builders are reluctant to accept the much higher risk.

Since 1976, over half of the acceleration of inflation which has caused record interest rates and the collapse of the housing industry is attributable to Federal Government policies:

Acceleration of deficit spending resulting in quarterly and annual Federal deficits too high for scarcity of some skilled labor and capacity.

Too rapid growth of the money supply during 1977, 1978 and 1979 for the slowing growth of production.

Rapid growth of Federal regulations mandating costs and thus price increases.

Acceleration of Federal taxes, discouraging savings and investment.

Encouragement of workers to accept nonworker status to take advantage of faster growing income caused by Federal taxing and transfer spending programs which undermines the work ethic.

One-third of the acceleration in inflation since 1976 was caused by increases in OPEC prices.

One hundred million workers and business people are not a major cause of accelerating inflation. Compensation per man-hour has lagged behind inflation, profit margins from current production have declined.

The most recent response by the Federal Government to higher inflation and interest rates is to propose even higher inflation and higher interest rates during the next 6 months, and then promise to fight inflation after 6 months, in the next fiscal year, which is conveniently after the November elections.

The President advertised spending cuts (slowdown) of $2 billion but failed to advertise spending increases of $6 billion, or a net increase in Federal deficit spending of $4 billion for fiscal year 1980. The House and Senate Budget Committees are essentially endorsing the President's lead.

The President's proposed credit policies have caused interest rates to be higher than otherwise and further hurt housing. The President is imposing an import fee that will drive up gasoline prices, enough to cause about one-half percent increase in overall consumer prices in the short run and 2 percent higher consumer prices in the long run.

To add insult to injury, the Government has increased wage and price regulations as a political way to shift blame to workers and business people, and away

from the Federal Government. Thus, the housing industry and other people adversely affected by higher interest rates and higher inflation now are left with even more harmful Government policies during the next 6 months.

The President and the House and Senate Budget Committees promise to repent next fiscal year, after the election. They promise to slow spending growth modestly. However, Americans remember the promises last year at this time when both the President and the Congress (first concurrent budget resolution) promised an 8-percent growth in Federal spending which has now risen to over 15 percent. Promises with this track record and with no effort to fight inflation with fiscal policy now are not credible and the stock and bond markets have told us so.

Government policymakers are saying that they will only add to inflation and not fight inflation with fiscal policy. Government policy will fight inflation only with soaring interest rates and reliance on a recession in the private sector and with huge increases in tax burdens—$900 increase per household in 1980 and a record $1,200 in 1981. This sacrifice is made so the Federal Government can experience boom spending. The situation is so perverse that recipients of Federal spending programs that do not require work are receiving a faster growth income than the workers who pay the taxes for these programs. Where people are eligible, the message is clear: it pays not to work.

The Government's proposed increase in inflationary deficit spending for the remainder of this year and record increases in tax receipts for next year are contrary to the preferences of the majority of the people of the United States, as indicated by recent Gallup surveys. Thus, Government policies are contrary to the will of a majority of Americans.

Improvement in Government policies to fight inflation, lower interest rates, and reversing the trend in housing need not be drastic and disruptive. Two percentage points slower growth in spending during the next 18 months would achieve a balanced budget in 1981 and allow for tax relief to stimulate savings and investment beginning in 1981 and extending into subsequent years. In particular, we recommend:

Slow Federal spending by 2 percent or $6 billion during the remainder of 1980 so that spending totals no more than $563 billion.

Slow spending by 2 percent or $17 billion during 1981 so that spending totals $595 billion.

Achieve a balanced budget in 1981 by slowing spending and not by increasing tax receipts higher than $595 billion.

Begin tax relief to encourage savings and investment in 1981, with larger tax relief in subsequent years.

Maintain spending growth significantly less than the growth of people's income.

Avoid additional wage, price, and credit controls and phase out existing controls.

The modest 2-percent solution could significantly reverse the trend in inflation and interest rates during the next 90 days:

Reduce producer prices by 3 to 5 percent, from 20 to 15 percent.

Reduce inflation in consumer prices by 3 percent, from 18 percent to 15 percent.

Reduce some short-term interest rates by 5 percent, from 22 percent to 17 percent for construction loans.

Reduce mortgage interest rates from 15 to 17 percent to an average of 14 percent.

Over the longer run, the 2-percent solution could achieve the following:

New housing construction each year could increase by over 400,000 units by the mid-1980's.

One million addition households could upgrade to better housing each year.

Investment in productivity-increasing commercial and industrial structures and equipment could increase by over 20 percent by the mid-1980's.

Productivity could increase by over 2 percent by the mid-1980's.

Inflation could trend downward to less than 7 percent by the mid-1980's.

Employment could increase by over 1 million additional jobs by the mid-1980's.

Average spendable income per household could increase by $900 by the mid-1980's.

THE OUTLOOK FOR HOUSING

Housing is reeling under the weight of bad economic policies; increasing quarterly Federal deficits forcing restraining money growth and high interest rate policies. The dropoff in housing activity is widespread, with sharp sales declines reported in all sections of the country and for all types of residential real estate.

Existing home market

Sales of existing homes have tumbled to a seasonal adjusted annual rate of 2,700,000 units in March, a drop of 35 percent from the most recent peak (October 1978) and 30.8 percent since last October, and worse is yet to come. The drop in sales makes this by far the worst decline for the existing home market in the post World War II period and, unfortunately, sales activity has not reached bottom yet. Previous steep drops occurred during the 1969–70 credit crunch and the 1973–75 crunch (Table 1).

TABLE 1.—PERIODS OF DECLINE IN EXISTING HOME SALES

	Peak	Trough	Percent change	Duration (months)
1969 to 1970	1,710,000	1,370,000	—19.9	15
1973 to 1975	2,500,000	2,040,000	—18.4	23
1979 to (?)	4,060,000	2,700,000	—33.5	[1] 16

[1] So far.

Source: National Association of Realtors.

Housing construction

Residential construction is also in a nose dive. Private housing starts are currently off a whopping 35 percent over the past 15 months. This puts the rate of construction at its lowest level in 50 months. Further declines are expected ahead until the starts forecast to drop below one million units in the next few months. Unfortunately, the declines in housing production are coming at a time in our nation's history when the need for housing is most acute.

To accommodate the expected rapid growth in household formations we need to produce at least 2 million housing units a year during the decade of the 1980's. The 1979 production of new homes fell short of this goal by 250,000 units and we anticipate an 800,000 unit shortfall in 1980. This lost production will not be easily made up. If the housing industry produces at full capacity of 2.2 to 2.3 million units a year, it would take five years before our nation is able to make up for the production lost during 1979 and 1980 (Table 2).

TABLE 2.—PRIVATE HOUSING STARTS

[Seasonally adjusted annual rates in thousands]

	Total	Single family	Multifamily
1977	1,987	1,451	536
1978	2,020	1,433	587
1979:			
April	1,745	1,273	477
May	1,835	1,451	536
June	1,923	1,276	634
July	1,788	1,222	542
August	1,793	1,237	551
September	1,874	1,237	637
October	1,710	1,139	571
November	1,522	980	542
December	1,548	1,055	493
1980:			
January	1,424	1,006	418
February	1,334	774	560

Source: U.S. Department of Commerce.

New home sales

The market for new homes is also in sad shape—the decline in new home sales is now certain to exceed the experience of the 1973–75 credit crunch when sales plummeted 45 percent. Government figures show that new homes sales in February fell 9.5 percent from January to a seasonally adjusted annual rate of 532,000 units.

New home sales have now fallen 26 percent since the inadequate economic policies of the Administration and the Congress forced the Federal Reserve Board to raise interest rates in October, and have fallen fully 41 percent since

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their cyclical peak reached in October of 1978. At the February rate of sales, it would take more than 9 months to sell off the inventory of approximately 387,000 new homes now on the market.

Fewer home sales mean lower levels of housing construction and rising unemployment among the nation's million construction workers who already have an unemployment rate of 13 percent—double the rate for all workers.

Rising home prices and increasing interest rates have had a substantial impact on housing affordability. In March 1980, a median priced existing single-family home purchased with a 30 year, 80 percent mortgage, required monthly principal and interest payments of $607. This represents an alarming 54 percent increase over the payments of $393 required one year earlier, prior to the Fed's actions. Similar increases are also facing prospective purchasers of new homes (Table 3).

TABLE 3.—MONTHLY PAYMENTS FOR PRINCIPAL AND INTEREST ON EXISTING SINGLE-FAMILY HOMES

[80 percent mortgage, 30-yr term]

	Median price (thousands)	Effective rate	Mortgage (thousands)	Mortgage payment
Existing:				
1979:				
January	$52.0	10.25	$41.6	$373
February	51.9	10.50	41.5	380
March	53.8	10.50	43.0	393
April	54.7	10.50	43.8	401
May	55.9	10.50	44.7	409
June	56.8	10.75	45.4	424
July	57.9	11.00	46.3	441
August	57.7	11.25	46.2	449
September	57.3	11.25	45.8	445
October	56.3	11.25	45.0	437
November	55.6	11.50	44.5	441
December	56.5	12.00	45.2	465
1980:				
January	57.9	12.25	46.3	485
February	59.0	13.00	47.2	522
March	60.0	15.00	48.0	607

Source: National Association of Realtors.

The cost of construction loans which generally averages 2 to 3 points over prime has jumped to 22 percent, fully 8 percentage points higher than the 14 percent which prevailed at this time last year. These higher costs will be reflected in future home prices worsening the affordability problem and pricing home buyers out of the market.

The affordability problem is illustrated by the fact that the monthly mortgage payment for a median-priced existing home requires 26 percent of average disposable household income in March, 1980, contrasted to 19 percent in 1979 (attachment 1).

The growth of inflation

The current Administration has underestimated inflation in each of its annual budget and economic messages, and we believe it has done so again this year (see Table 4).

TABLE 4.—ADMINISTRATION'S INACCURATE CONSUMER INFLATION FORECASTS

[December to December]

	1977	1978	1979	1980	1981
President Carter	5.3	5.2	6.0	[1] 6.3	8.6
Actual (and Realtors latest estimates for 1980 and 1981)	6.8	9.0	13.2	[2] 15.6	[2] 12.4
Difference—Carter and actual (or Realtors latest estimates)	1.5	3.8	7.2	9.3	3.8

[1] In the Jan. 28, 1980, budget the administration revised this upward to 10.4 percent; on Mar. 31, 1980, the administration's budget revisions forecast 12.8 percent.

[2] National Association of Realtors forecast, April 1980.

Sources: Budgets of the United States and 1981 budget revisions, Office of Management and Budget; National Association of Realtors.

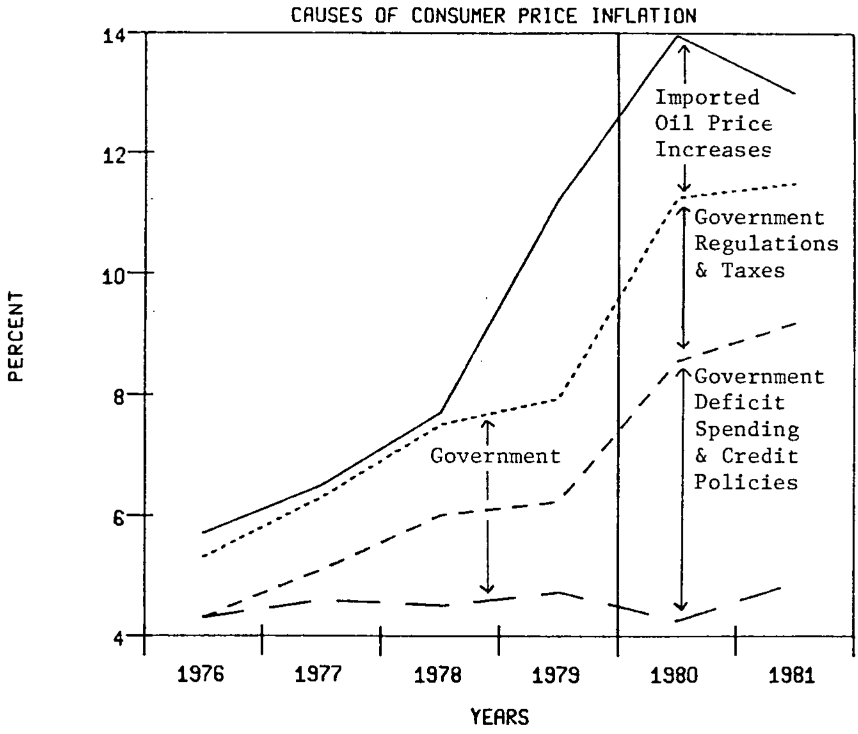
In light of this, nobody should be surprised that the policies and budgets which the Administration has advocated and the Congress has enacted each year not only have failed to overcome inflation but have increased it.

What causes inflation

Excessive growth in federal spending, higher taxes that add to the costs of production, the increasing cost of government over-regulation and the excessive growth of credit between 1973 and 1978 have been the major causes of the recent acceleration in inflation, increasing prices nearly 5 percent in 1979 alone. Government has accounted for over one-half of the acceleration in inflation from 4.8 percent during 1976 to 13.2 percent during 1979 and 18 percent so far in 1980.

Increases in world oil prices were a less important cause of inflation, being responsible for only one-third of the increase in consumer prices in 1979 (see Graph 1).

GRAPH 1



After contributing to inflation through excessive expansion of the money supply over the past 5 years, the Federal Reserve Board, since October, has been leaning against inflation with tight credit policies, forcing up long-term mortgage interest rates by over 5 percentage points in the last 12 months.

Without a slowing in spending, tight credit policies will be ineffective in reducing inflation and, in fact, will add to long-run inflation by reducing productivity-increasing investment and causing shortages in the housing supply.

Federal budgets in fiscal year 1980 and fiscal year 1981

Despite the advertised spending "cuts" announced in March, the Administration and Congress are continuing the trend towards excessive and inflationary increases in Federal spending and taxes, with Federal expenditures taking even larger shares of people's income and the Nation's output.

The administration proposes increasing budgeted spending in fiscal year 1981 to $612 billion, up $43 billion from fiscal year 1980. This follows an anticipated $76 billion spending increase in fiscal year 1980, to $569 billion. While the House and Senate Budget Committees' estimates for budgeted spending in fiscal year 1980 are slightly lower than the administration's, they propose almost identical spending in fiscal year 1981 (see table 5).

TABLE 5

	Budget spending (billions)			Average annual growth 1979–81 (percent)
	1979 actual	1980	1981	
President Carter	$493	$569	$612	11.4
Realtors 2 percent solution recommendation	493	563	595	9.9
House Budget Committee	493	567	612	11.4
Senate Budget Committee	493	566	613	11.5

Source: 1981 budget revisions; Recommendations of the House and Senate Budget Committees on the First Concurrent Budget Resolution, Fiscal Year 1981; National Association of Realtors.

Growth in non-defense areas will be the main cause of increases in budgeted expenditures over the next 2 years, accounting for over 71 percent of the increase in budgeted spending between 1979 and 1981 under the administration's proposals, 74 percent under the House Budget Committee's recommendation and 68 percent under the Senate Budget Committee's recommendations.

Clearly, then, excessive growth in federal spending proposed by the administration and Congress has not been prompted by national security considerations alone.

Even the high spending figures may be underestimated however, when the administration presented the budget in January last year, it was described by the President as "lean and austere" calling for a mere $38 billion increase in federal spending in fiscal year 1980 to $532 billion. By the Second Concurrent Budget Resolution, proposed spending in FY 1980 had risen to $548 billion. By January of this year the Administration's proposed spending for the current fiscal year had grown to $564 billion. After the March revisions and "cuts", the Administration's budgeted spending for fiscal year 1980 is $569 billion, up a massive 15.3 percent from 1979 (see Table 6). Given past underestimates of inflation and pressures on Congress from special interest groups for increased spending in this election year, there is a clear danger that these events could be repeated in fiscal year 1981, to the cost of the housing industry and the nation as a whole.

TABLE 6.—HISTORY OF PROPOSED FEDERAL SPENDING IN FISCAL YEAR 1980

Estimate	Date	Proposed budgeted outlays (billions)
Administration proposal	January 1979	$532
First Concurrent Budget Resolution	May 1979	532
Second Concurrent Budget Resolution	October 1979	548
Administration estimate contained in fiscal year 1980 budget	January 1980	564
Administration re estimate in 1981 budget revision	March 1980	569

Source: Budgets of the U.S. Government, 1980 and 1981, 1981 budget revision and National Association of Realtors.

Increases in federal spending and taxation are encouraging a reduction in hours worked by workers in the United States. According to a recent study by Data Resources, Inc. the increase in average effective tax rates in the United States since 1965 has reduced the labor force by 1.9 million persons, or 1.8 percent. This represents a drop in potential output of almost $30 billion per year, or nearly $400 per household. When account is taken of the effect of higher tax burdens on hours worked per worker remaining in the labor force, the cost to the economy is almost certainly much greater.

Federal spending programs which allow faster growth of benefits for eligible non-workers than the growth of taxpayers' income are also encouraging a reduction in hours worked and therefore national output.

Public support for a change in budget policy

The government's proposed increase in inflationary deficit spending for the remainder of this year and record increases in tax receipts for next year are contrary to the preferences of the majority of the people of the United States, as indicated by recent Gallup surveys. Thus, government policies are contrary to the will of a majority of Americans.

In the Realtors® Quarterly Survey of a personal interview cross-section of 1,584 households conducted February 1–9, 1980 by the Gallup organization the respondents were taken to "best describe what you think government policy should be?" More than half called for slower spending and of those calling for slower spending more than one-half recommended tax relief. Slower growth of spending with tax relief were preferred most by all Americans, irrespective of income, age, or party affiliation (see Table 7).

TABLE 7.—PREFERENCE OF AMERICANS CONCERNING FEDERAL SPENDING AND TAXING POLICIES DURING THE NEXT YEAR

[Percent of respondents]

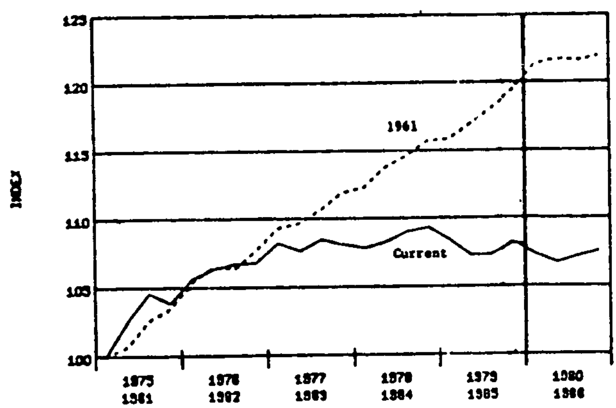
	Continue 12 percent spending growth		Slower spending growth		
	With no tax relief	With tax relief	With no tax relief	With tax relief	Don't know
All	15	17	24	29	15
Less than $20,000 income	13	19	21	28	19
$20,000 and more income	19	14	30	32	6
Less than 35 yr old	14	21	24	28	14
35 yr and older	15	15	24	30	16
Political affiliation:					
Republican	16	14	28	29	14
Democrat	16	19	22	26	16
Independent	12	17	25	34	12

The productivity problem

One of the major factors behind the increase in the rate of inflation has been the slow growth in worker productivity in the United States. The growth rate in average output per worker has declined from 3.5 percent per year figure achieved in the early 1960's to near zero from 1977–79. After adjusting for recessions, productivity growth has slowed considerably during the recovery since 1975 compared with the only other long economic recovery during the last 30 years (see graph 2).

GRAPH 2

OUTPUT PER HOUR WORKED (PRODUCTIVITY) IN THE NON-FARM BUSINESS SECTOR DURING CURRENT AND 1961 RECOVERIES (1975:1 AND 1961:1 = 100)

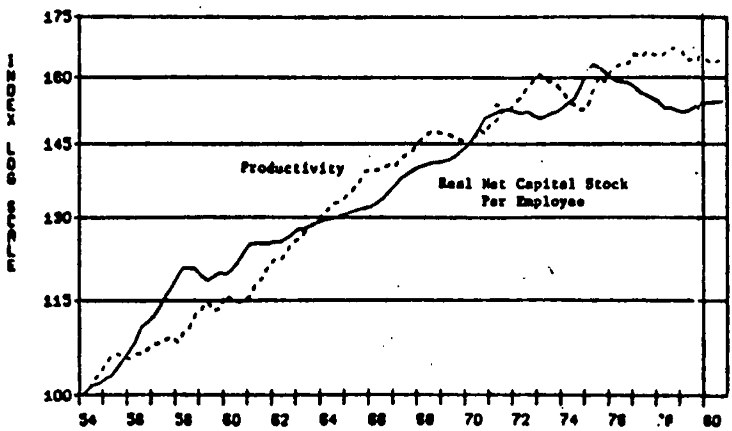


SOURCE.—U.S. Department of Commerce, Bureau of Economic Analysis for historical data; National Association of Realtors® for forecast data.

This comparatively slow growth rate of productivity is in large part due to the slow rate of growth of capital per worker in the United States since 1970. Investment has not grown to keep pace with the increase in the labor force, particularly since 1975. Consequently, real net capital stock per employee has declined and little, if any improvement is expected in the year ahead (see graph 3).

GRAPH 3

REAL NET CAPITAL STOCK PER EMPLOYEE AND OUTPUT PER HOUR WORKED (PRODUCTIVITY) (NON-FARM BUSINESS SECTOR) (1954:1 = 100)

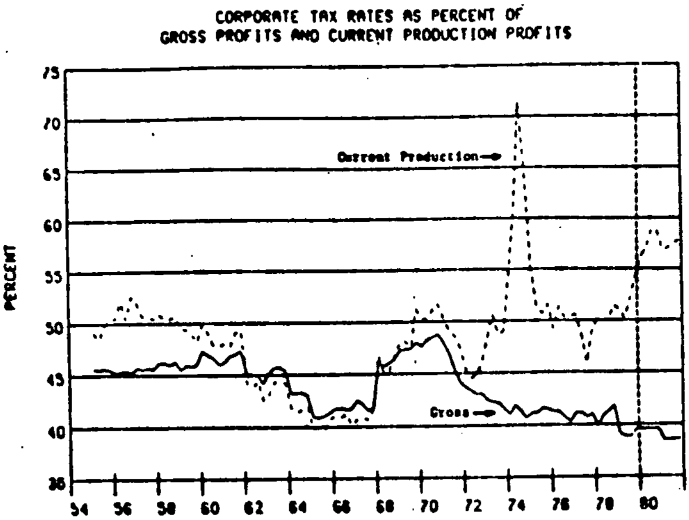


SOURCE.—U.S. Department of Commerce, Bureau of Economic Analysis for historical data; National Association of Realtors® for forecast data.

The U.S. currently has the lowest rate of capital investment among the major industrial powers investing less than 17 percent of its gross national product in capital formation (including housing). In comparison, West Germany and Japan invest 25 percent and 35 percent respectively. Growth in capital per worker has been high or at least positive among industrialized countries in recent years, except for the United States. Our savings performance also ranks the lowest of industrialized countries—only 3.5 percent of personal disposable income is currently saved.

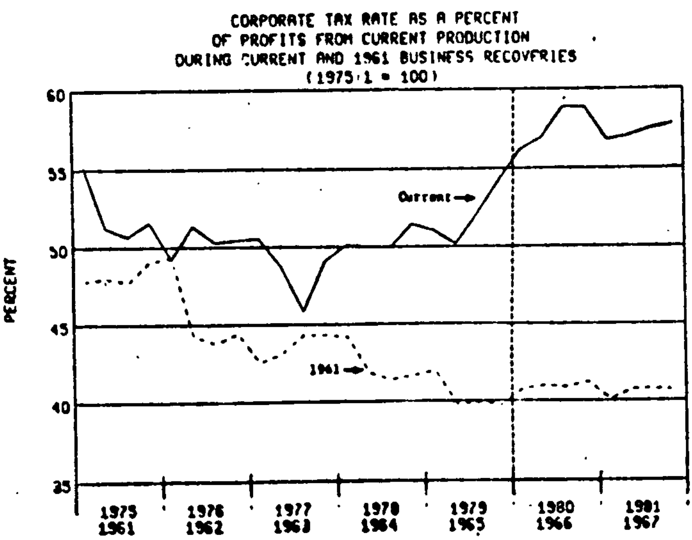
Investment within the United States has been low partly because after tax profits from current production (after the U.S. Department of Commerce adjusts for corporate taxes, inadequate depreciation and overstatement of profits from inventories) have fallen to less than 4 cents on each sales dollar and are forecast to drop below 3 cents. High Federal taxes are a major cause of this decline in investment incentive. Federal taxes siphon away more than 54 percent of profits from current production and will siphon even more during 1980 (see graph 4).

GRAPH 4



This increase in the corporate tax burden is even more obvious when a comparison is made of corporate tax rates during the only two long economic recoveries in the last 35 years (see graph 5).

GRAPH 5



Excessive growth in Federal spending is another major cause of the slow growth in capital per worker. Large increases in government spending not only push up interest rates and inflation, diverting resources away from productive investment in new structures, equipment and housing directly, but also effectively preclude significant tax relief directed towards stimulating increased savings and investment.

Growth in government regulations which add to business costs is also adding to the decline in business profitability and, therefore, the incentive to invest.

The 4-year 66 percent increase in the budgets Federal regulatory activity under the current Administration is causing nearly 2 percentage points of the current and forecast growth in prices and squeezing profit margins (based on Professor Murray Weidenbaum's estimates of the relation of budget costs to costs for the economy).

The stricter enforcement of the Administration's wage and price guidelines will lead to a further reduction in profit margins. Adherence to the Administration's guidelines would cause corporate profits to grow more slowly than both wages and prices.

Recent policy responses on inflation

In response to the 18 percent inflation rate experienced so far this year, the Federal government now proposes measures which will result in even higher interest rates and higher inflation during the next 6 months.

In addition to the inadequate "cuts" in Federal spending in fiscal year 1981, cuts which were offset by upward "revisions" expenditures in other areas, the Administration has proposed increasing taxes, more credit controls and stricter enforcement of "voluntary" wage and price regulations.

The imposition of the fee on imports of crude oil and gasoline will add more than 10 cents per gallon to retail gasoline prices and result in up to 2 percent higher consumer prices by 1981. The inflationary impact of these tax increases will more than offset any benefits from the inadequate spending cuts over the next 18 months.

The Administration also introduced tighter credit policies and more credit controls to fight inflation. The discount rate for certain bank borrowers was increased 3 percentage points, and 15 percent reserve requirements placed on increases in the assets of money market funds and certain categories of consumer borrowing. The Federal government also increased direct regulations on credit, introducing a "voluntary" credit restraint program on loan growth of large banks and increased reserve requirements on increases of managed liabilities of both member and non-member banks.

These tighter credit policies will further drive up interest rates and result in even larger declines in housing activity over the next 9 months.

The inappropriate mix of economic policies—excessive tight credit after years of over expansion and loose fiscal policies—will be ineffective in fighting inflation and result in needless declines in future output in the housing and investment industries.

In recent months the administration has announced: extension for another year of price standards and revision of pay standards; tripling of the Council on Wage and Price Stability's staff monitoring prices and pay; doubling the number of companies automatically reporting prices to COWPS; intention to call for prenotification to COWPS of some price increases; and the intention aggressively to identify publicly companies that fail or refuse to comply with price standards.

Attachments.

RELATIONSHIP OF MORTGAGE PAYMENT COSTS TO HOUSEHOLD INCOME

	Average disposable income per household	Monthly mortgage payment (P. & I.) for median priced existing homes	Payment as percent of monthly income
1977	$20,460	$276	16
1978	22,766	328	17
1979:			
March	24,920	393	19
June	25,577	424	20
September	26,287	445	20
December	26,905	465	21
1980: March	27,559	607	26

MORTGAGE BANKERS ASSOCIATION OF AMERICA, NATIONAL ASSOCIATION OF HOME BUILDERS, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, NATIONAL ASSOCIATION OF REALTORS®, UNITED STATES LEAGUE OF SAVINGS ASSOCIATIONS

APRIL 1, 1980.

The Honorable,
U.S. Senate,
Washington, D.C.

DEAR SENATOR: We, the undersigned, strongly endorse sounder economic policy for a real fight against inflation and to reduce both short term and long term interest rates. In particular, we strongly recommend that you vote to:

(1) Slow federal spending by at least 2 percent or $6 billion during the remainder of 1980 so that spending totals no more than $563 billion.

(2) Slow spending by at least another 2 percent or $18 billion during 1981 so that spending totals less than $595 billion.

(3) Achieve a balanced budget in 1981 by slowing spending and not by increasing tax receipts higher than $595 billion.

(4) Propose to earmark the receipts from the crude oil import fees to stimulate capital formation.

We are confident that these recommendations if acted upon in the revised Second Concurrent Budget Resolution for fiscal year 1980 and the First Concurrent Budget Resolution for 1981, would help reverse the trend of inflation and interest rates. We would expect that interest rates would subsequently decline to help reduce the stress upon the housing industry and other investment. Thus, we would expect the resulting balance of economic policy to place less strain on this sector of the economy in relationship to other sectors of the economy.

We, the undersigned, represent several million Americans and strongly recommend this path back toward economic health.

Sincerely,

SAUL B. KLAMAN,
President,
National Association of Mutual Savings Banks.

ROBERT G. BOUCHER,
President,
Mortgage Bankers Association of America.

RALPH W. PRITCHARD,
President,
National Association of Realtors®.

MERRILL BUTLER,
President,
National Association of Home Builders.

EDWIN B. BROOKS, Jr.,
President,
United States League of Savings Associations.

OUTLOOK FOR THE U.S. ECONOMY AND REAL ESTATE

	Quarters								Years			
	1979:4 actual	Forecast							Actual		Forecast	
		1980:1	1980:2	1980:3	1980:4	1981:1	1981:2	1981:3	1978	1979	1980	1981
AGGREGATE ECONOMY												
Gross national product (billions of dollars)	2,457	2,524	2,576	2,621	2,703	2,787	2,880	2,992	2,128	2,369	2,606	2,944
Percent change	10.5	11.4	8.6	7.1	13.1	12.9	14.1	16.5	12.0	11.3	10.0	13.0
Percent change (without inflation)	2.0	1.1	−3.9	−4.7	0.6	1.8	3.4	5.7	4.4	2.3	−0.4	1.4
Consumption	4.1	0.3	−2.8	−2.1	1.6	−0.4	1.5	4.2	4.5	2.6	0.5	0.8
Residential investment	−4.9	−29.2	−47.4	−34.8	−0.2	29.1	41.3	43.6	4.2	−5.7	−23.6	10.0
Nonresidential investment	−0.5	5.8	−6.3	−5.2	0.7	0.8	5.0	4.6	8.4	6.2	0.7	1.2
Structures	11.9	6.1	−5.2	−6.8	−6.5	−5.3	−0.5	1.3	12.2	9.6	3.3	−3.4
Equipment	−5.9	5.6	−6.8	−4.4	4.4	4.0	7.7	6.1	6.7	4.7	−0.5	3.5
Exports	7.1	1.4	0.8	0.1	2.1	4.4	5.4	6.8	10.6	10.1	4.4	3.8
Imports	8.1	−2.3	−5.4	−3.4	−1.0	2.8	4.5	4.8	11.1	4.4	−0.4	1.6
Government purchases	6.0	6.5	−2.8	−1.5	−0.4	1.2	0.7	1.9	1.8	0.4	1.8	0.3
Residential investment (percent of GNP)	3.9	3.5	3.0	2.8	2.8	2.9	3.2	3.4	4.3	4.0	3.0	3.3
Nonresidential structures investment (percent of GNP)	3.5	3.5	3.5	3.5	3.4	3.4	3.3	3.3	3.1	3.4	3.5	3.3
Inventory change (billions of dollars)	5.6	5.6	10.1	−1.4	−7.1	−0.8	3.1	7.5	22.3	18.1	1.8	6.6
Manufacturing capacity utilization rate (percent)	85	84	81	78	77	78	79	80	84	86	80	80
Manufacturing industrial production (percent change)	−1.0	0.0	−8.3	−11.1	−2.0	4.6	8.8	11.7	6.1	4.4	−3.3	2.5
Employment (millions)	97.7	97.9	97.7	97.7	97.7	98.0	98.4	98.9	94.4	96.9	97.8	98.7
Unemployment rate (percent)	5.9	6.1	6.6	7.0	7.3	7.5	7.6	7.5	6.0	5.8	6.7	7.5
Real disposable income per household (percent change)	0.3	−1.2	−4.8	−1.8	−1.2	−0.4	1.7	3.0	3.8	1.5	−1.7	0
Disposable income per household (average)	26,287	26,905	27,559	28,300	29,071	29,896	30,833	31,865	22,766	25,306	27,959	31,378
Total taxes per household (average)	11,730	11,930	12,243	12,366	12,716	13,154	13,572	14,064	10,114	11,211	12,314	13,844
Percent change	13.7	7.0	10.9	4.1	11.8	14.5	13.3	15.3	12.3	10.8	9.8	12.4
Consumer price inflation (CPI)	13.6	18.7	17.6	14.2	12.1	12.1	12.6	12.7	7.7	11.3	15.5	12.8
Producers price inflation (WPI)	16.6	22.3	19.6	16.2	15.6	14.7	14.1	14.1	7.8	12.5	18.1	15.1
Gross national product inflation (GNP deflator)	8.3	10.1	13.0	12.4	12.5	10.9	10.3	10.3	7.3	8.9	10.5	11.3
Residential construction inflation	7.0	9.2	10.6	10.9	12.5	13.4	14.7	14.4	13.1	12.4	10.3	13.2
Nonresidential construction inflation	10.0	10.1	11.4	10.8	11.4	12.1	13.2	13.0	8.8	10.5	10.8	12.2
Compensation per man-hour (percent change)	9.1	11.2	11.2	11.5	12.6	10.8	11.3	11.3	8.5	9.0	10.4	11.4
Productivity (percent change)	0.3	−1.9	−4.3	−4.2	−0.2	0.0	0.8	2.3	0.5	−1.1	−2.2	−0.3
Unit labor cost (percent change)	8.5	13.5	16.2	16.3	12.8	10.8	10.5	8.7	8.0	10.2	12.9	11.7
Before tax corporate profits (billions of dollars)	246	252	242	228	228	228	237	255	206	237	238	247
Corporate tax liability	97	100	96	90	90	88	91	98	85	93	94	95
After tax profits	149	152	147	138	138	141	146	157	122	145	144	152
Inventory valuation adjustment	−47	−59	−58	−55	−49	−50	−51	−55	−25	−42	−55	−53
Capital consumption adjustment	−20	−20	−22	−23	−25	−23	−25	−28	−13	−17	−22	−26

Profits from current production	82	73	67	62	63	68	70	75	83	86	66	72
Adjusted for inflation (1979:4 base)	82	72	63	57	57	59	60	62	93	89	62	61
Percent change, year ago	—15.8	—23.2	—31.1	—35.4	—31.1	—17.0	—5.7	8.3	0.2	—4.6	—30.1	—2.6
Per unit of output (percent of GNP)	3.3	2.9	2.6	2.4	2.3	2.5	2.4	2.5	3.9	3.6	2.6	2.5
Effective corporate tax rate (percent)	54	58	59	59	59	56	57	57	50	52	59	57
Federal tax receipts (NIA basis)	526	538	558	565	586	612	635	662	432	498	562	650
Federal expenditures (NIA basis)	540	556	579	598	620	629	642	664	460	509	588	655
Surplus or Deficits (NIA basis)[1]	—15	—18	—22	—33	—35	—17	—7	—2	—28	—11	—27	—5
REAL ESTATE MARKETS												
Existing single-family home sales (thousands)	3,557	2,971	2,895	3,091	3,273	3,421	3,574	3,728	3,863	3,701	3,057	3,692
Percent change, year ago	—11.0	—19.9	—22.4	—18.9	—8.0	15.2	23.5	20.6	8.8	—4.2	—17.4	20.8
Dollar volume (billions)	231.2	197.3	202.9	224.2	239.0	258.8	284.1	311.0	214.4	237.6	215.8	296.4
New single-family home sales (thousands)	613	564	562	599	633	663	672	690	817	712	590	677
Percent change, year ago	—26.9	—24.3	—21.3	—19.1	3.3	17.5	19.5	15.2	—0.4	—12.9	—16.1	14.8
Private housing starts (thousands)	1,593	1,345	1,091	1,005	1,185	1,342	1,486	1,658	2,020	1,744	1,156	1,563
Single family	1,058	834	718	702	858	939	1,058	1,161	1,433	1,193	778	1,098
Multifamily	535	512	373	303	327	403	428	497	587	551	379	465
Subsidized	59	149	151	151	174	136	156	155	135	120	156	156
Mobile home shipments (thousands)	262	260	207	172	173	190	191	209	278	273	203	202
Housing inventory (millions)	83.3	83.5	83.7	83.9	83.9	84.1	84.3	84.5	81.4	82.8	83.8	84.4
Rental vacancy rate (percent)	5.0	4.9	4.8	4.8	4.9	5.1	5.2	5.2	5.0	5.0	4.8	5.1
Unsold new homes (percent of sales)	67.6	69.4	76.5	78.2	78.2	75.8	70.9	66.5	50.0	59.6	75.6	69.3
Office vacancy rate (percent)[2]	3.6	3.3	3.4	3.6	3.8	4.0	4.1	4.2	6.4	4.4	3.5	4.1
Industrial vacancy rate (percent)[2]	3.5	3.8	4.2	4.5	4.5	4.0	3.7	3.5	2.8	3.0	4.3	3.6
Existing home prices, median (thousands of dollars)	56.1	58.1	61.0	63.3	63.6	65.7	68.0	70.3	48.7	55.5	61.5	69.2
Percent change, year ago	11.0	10.5	9.4	9.9	13.2	13.1	11.3	11.0	13.9	14.1	10.8	12.4
New home prices, median (thousands of dollars)	62.2	64.8	67.9	71.1	71.3	71.9	75.7	79.6	55.8	62.7	68.8	77.3
Percent change, year ago	5.8	6.8	8.7	8.6	14.6	10.8	11.4	11.9	13.9	12.4	9.7	12.3
FINANCIAL MARKETS												
Total time and savings deposits (percent change)	11.1	8.3	5.7	4.1	3.6	5.1	5.8	6.9	11.7	9.4	7.2	5.3
Savings rate (percent)	3.5	3.4	3.2	3.5	3.1	3.4	3.7	3.6	4.9	4.6	3.3	3.6
New Mortgage commitments (billions of dollars)	104.7	103.0	63.5	69.0	73.4	94.6	109.4	122.2	136.0	123.0	77.2	112.7
Percent change, year ago	—29.4	—14.0	—52.0	—49.0	—29.9	—8.2	72.3	77.2	1.6	—9.6	—37.2	46.0
Mortgage debt outstanding (billions of dollars)	1,304	1,335	1,360	1,380	1,403	1,432	1,463	1,497	1,113	1,264	1,369	1,481
Money supply (M2) (percent change)	9.2	0.9	4.5	3.9	5.7	6.0	6.1	6.0	8.6	8.0	5.73	5.6
New home mortgage commitment rate (percent)	12.27	13.60	15.00	14.50	14.20	13.90	13.70	13.50	9.69	11.23	14.32	13.60
AAA corporate bond rate (percent)	10.54	12.33	13.16	12.73	12.34	11.65	11.48	11.50	8.72	9.63	12.64	11.56
Prime rate (percent)	15.08	16.53	19.10	17.14	14.60	13.39	13.12	12.79	9.06	12.67	16.84	13.07
Federal funds rate (percent)	13.58	15.09	16.52	14.47	12.49	12.58	12.01	11.65	7.93	11.19	14.64	12.08

[1] Assumptions income a $10,000,000,000 rollback in scheduled social security taxes after 1981:1 and a $5,000,000,000 (annual rate) cut in corporate income taxes beginning 1981:1.

[2] Historical data courtesy of Coldwell Banker.

Source: Model developed by the National Association of Realtors, and Data Resources, Inc. Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, Kenneth Kerin, and Glenn Crellin.

Senator BENTSEN. Thank you very much, Mr. Carlson. Let me first urge everyone to limit their questions to 5 minutes. And I will ask someone to keep time.

Now you look up there on that chart and you see where housing starts have dropped to—down to the 1 million figure. And single-family dwellings are substantially below that on an annualized basis. And then you look at what has happened to interest rates and, obviously, that is interest rates on loans closed, not on forward commitments, which would be substantially above that.

Now, Mr. Partee, you put a restriction on an increase in credit. And it was 6 percent and 9 percent, as I understand it.

Mr. PARTEE. That's right.

Senator BENTSEN. Allowing for growth areas. Now I notice here in your testimony you say "banks were asked to give priority attention to maintaining a reasonable availability of funds to small businesses such as local builders."

Now Mr. Partee, I have served on bank boards and I know who they generally take care of first. And when times get tight and tough and money is hard to get, they take care of their big company customer first because they are scared to death that they are going to lose them to a competitor.

And the small businessmen and the individual and the homebuilder get taken care of generally way down the line.

What makes you think that the Fed's instruction is being carried out? What are you doing to enforce it? Does the 9-percent limitation exclude loans to homebuilders or not? And if it doesn't, why shouldn't it? Why shouldn't you have a segregated account to try to help the homebuilder?

Mr. PARTEE. In response to your last question, Senator, we haven't defined the 9 percent to exclude any particular category. We do take the position, which we are going to be writing the banks of the country about today or tomorrow, that to the extent their new loans are made to small businesses and farmers, as well as to homebuilders, this would be a justification for going over the range.

But, you see, if we segregate it, then the 9-percent increase——

Senator BENTSEN. Why don't you make it 8 percent and let them segregate it?

Mr. PARTEE. I think it is a very difficult thing to do. We would rather look at their figures. As for the larger banks, we are getting monthly reports from them.

Senator BENTSEN. Do you think if General Motors or Exxon asked for some additional credit, that they would get it, or do you think that the small homebuilder or the small businessman is going to get it?

Mr. PARTEE. I agree that it is very difficult to get credit rejected for the very large businesses. If credit flows go to the very large businesses for the purposes of commodity speculation, inventory accumulation, or takeovers, which we have indicated should not be done, we will talk seriously to the institutions that are involved and, of course, if this isn't sufficient, we will have to do something more.

Senator BENTSEN. I hope you do something before fellows like this go under. And I'm not speaking about Mr. Stephens' own personal financial situation but some of these homebuilders don't have extended lines of credit and don't have the financial resources.

And I really think that this going through this boom and bust cycle is an archaic way of handling the situation. It takes it out on the homebuilders more than any other industry I know. And it can't help but lead to inefficiencies in that industry and lack of continuity of experienced people that build homes, be it the management or be it the carpenter or the plumber or the electrician.

They just go into other lines of endeavor rather than put up with this kind of a cycle.

We have got to come up with better answers.

Mr. PARTEE. We agree with that. We have studied this matter at great length and have made efforts to try to keep money flowing into housing.

As Mr. Janis said, this time we have developed the money market certificate to keep the thrifts in the business of getting savings. We have developed small consumer certificates also. And the open markets have been open to these institutions to a greater extent than ever before. But it is a very difficult problem because of the fact that housing, more than any other industry, depends almost totally on credit for financing rather than cash buying, and because the term of the loan is by far the longest of any kind of credit that is around in the country; thus, the interest component is relatively more important.

It is a very difficult problem, Mr. Chairman, unless you just force money into housing.

Senator BENTSEN. All right. Mr. Janis, the Senate Banking Committee recently reported a revised version of the Brooke-Cranston tandem plan. And of course that would be helpful to the homebuilding and the thrift industries.

What is your opinion of that legislation?

Mr. JANIS. Mr. Chairman, I have testified several times before on that and I have been asked how I feel about it.

It seems to me that Brooke-Cranston is a program that worked very well in the so-called crunch of 1974–75. It is a proven program. It provides a kind of a quick fix stimulus to housing generally and to housing starts.

Senator BENTSEN. I have another question and I just used up my 5 minutes. Let me ask you about the renegotiable mortgage. You talked about it being the salvation of the S. & L.'s.

What has been the Canadian experience?

Mr. JANIS. I have not talked about it in those terms as being the salvation.

Senator BENTSEN. I'm glad to have that corrected.

Mr. JANIS. I think it's going to be a useful device in the decade of the 1980's. Incidentally, I think this is a very opportune moment for consumers who can qualify to consider a rollover-type mortgage. It may be the only way that someone can take a chance and go into housing at the present time as a borrower if they know that they can borrow at 15 or 16 percent, but realize that in a couple of years, that rate could be significantly lower.

We are predicting much lower rates for the decade of the 1980's.

Senator BENTSEN. What is the experience of the Canadians with it?

Mr. JANIS. It has been very good, especially with regard to the last several years.

For instance, in the Canadian experience, if someone took out a mortgage in 1976 in one of these rollovers and it came due at this point, on the average on figures that we have run, the percent of disposable income that went for housing in 1976 on that mortgage would have been 25 percent; whereas today, with that same rollover at the present rates, it would only be 18.7 percent.

What has really happened here is that incomes in Canada have outpaced the increase in mortgage rates. So it has worked well in Canada, and I think it can work well here under the right set of circumstances.

Senator BENTSEN. Mr. Stephens, when it comes to building houses, is your problem—and I know that you are hurting both places, but let me ask you—is your problem more the high interest rate or is it the tight money?

Mr. STEPHENS. Well, in the particular price range house that I build——

Senator BENTSEN. My 5 minutes has expired, but yours has not. [Laughter.]

Mr. STEPHENS. We are in a move-up market situation. Our particular priced housing depends upon someone selling a smaller house, which might even be a starter house, and moving upward. It is an upward mobility.

What we are faced with is a people with a 9- or 10-percent fixed-rate mortgage looking at the possibility of accepting for a new house a 15 percent to 17 percent mortgage or a rollover, which if it is offered at 15 now, could also go up to 20. You know, it can go down and it can go up.

So if they are in a house right now, they are going to stay at the 9 and 10 percent or 8 percent mortgage that they have.

What we feel, I feel—not we, but I—is that mortgage rates are a tradition in America. The fixed rate is the tradition. People expect it and they cannot bring themselves around to paying such a high mortgage rate. There is no desire. You may want to buy a new house, but there is no desire to go out for a high interest rate mortgage.

That is just not in the American way.

Senator BENTSEN. Thank you, Mr. Stephens. I would like to call on members in the order in which they arrived.

Senator JAVITS. Mr. Chairman, may I make a unanimous consent request that I may submit written questions to the witnesses and have written replies and that they may be made part of the record?

Senator BENTSEN. Yes. Thank you very much, Senator Javits. You have been very patient and we appreciate your attendance.

I would like to call now upon Congressman Brown.

Representative BROWN. Thank you, Mr. Chairman.

Mr. Stephens, you mentioned a piece of legislation that I understand a builder, Mr. Smith of Pittsburgh, has been pushing, that tends to focus into the housing industry. But isn't the basic problem really broader than that? It is a savings problem.

Senator Bentsen on this committee has gotten the ball rolling on that by giving an exemption for the first $200 and $400, single and married, of interest on savings.

I've got legislation in that attempts to encourage people to save by giving them lower taxes on any investment income.

It occurs to me that that is where we have to try to put the emphasis, to encourage people to save so that there is more money available to be borrowed for housing and the other kinds of investment that are lagging in this country because, you know, it isn't just the housing industry. I come from Ohio and we've got a little problem with the steel industry in Ohio. It has got Youngstown flat on its back and some other communities are in difficulty because the industry that supplies the jobs in the area hasn't been able to modernize and to keep itself competitive with overseas competitors.

So would you be interested in supporting an effort that encourages savings in this country?

Mr. STEPHENS. Most definitely, Congressman. The piece of legislation that I referred to would give the thrift institutions a permanent stable source of low income accounts that they would not have to pay for.

This—of course I know I'm being narrowminded by saying it should go into housing or for home mortgages instead of steel and so forth. But the housing industry is what I'm involved in.

Representative BROWN. I understand. But if we take a specific answer for housing and another specific answer for steel and another specific—I mean automobiles—if we bail out Chrysler, we do all of these other fancy things, we are putting Band-Aids all over the whole economy to try to take care of individual problems.

And it occurs to me that maybe what we need to do is to take a thrust at the fundamental part of the problem, and that is just encourage savings all over.

Now there is another way to do it and that, of course, is to balance the budget, to get Uncle Sam, the overwhelming guy in this market, out of the markets so that he isn't in the market competing against people like you or your customers to try to borrow.

Mr. STEPHENS. Well, Congressman, what happens if the housing industry goes under? What happens to your budget?

I would hate to think.

Representative BROWN. What happens if Chrysler goes under? What happens if the steel industry in this country goes under?

I mean isn't the problem broader than just housing?

Mr. STEPHENS. As I said in my oral statement, the farmers, from what I understand, cannot even get loans to plant. I don't know how we're going to get bread this year, folks.

So this is the most ridiculous situation. It is something that I cannot understand why it exists when 6 months ago we thought there would be a softening—you know, the Professional Builder magazine predicted that the spring of 1980 was going to be the best sales market in history.

Representative BROWN. We've got those kinds of economists, too. [Laughter.]

The point of it, though, is that I think we have to put something in the way of a general change on here rather than just a lick and a promise on an individual industry.

And I guess that is the question I'm asking.

Mr. STEPHENS. Well, what we're doing is we're trying to fight inflation by raising interest rates, which we all agree is the wrong way.

To tell you the truth, if we got the labor unions, business leaders up on Camp David like we did the Israelis and the Egyptians and stayed up there and sent out for coffee until we came down from that mountain with an agreement, I think you would find inflation under control. You wouldn't have to raise the interest rates and put people out of work to get inflation down.

Now that is maybe an oversimplification, but you used to call it "jawboning." They used to talk about the Germans set their goals—excuse me—the West Germans set their goals, set the rate of growth and so forth, and get cooperation.

Representative BROWN. They also have a different tax system. And I would like to move on just to ask Mr. Carlson about the tax program that I was addressing.

Mr. Carlson, you've had a chance, I think, to look at H.R. 6400, the legislation that I put in to split income between earned income and investment income and reduce the taxes on investment income.

Another economist, Michael Evans of Evans Economics, has looked at it and says that he thinks the bill will cost about $13 billion, but stimulate about $20 billion in additional savings.

Have you had a chance to do any work on it yet?

Mr. CARLSON. Other than review it on a conceptual basis, we agree that it would add to additional savings and take the funds away from consumption, thereby adding to investment and consequently, you would have an increase in the standard of living in the future years.

I can't verify these numbers, however.

Representative BROWN. Well, when you get the opportunity, I would like to have it for the record.

Mr. CARLSON. I could say, though, that the President's proposals to increase the taxation of interest and dividends by earlier payment of the tax liability is a step in the wrong direction. That would reduce savings and investment out of the market place by $2 billion.

Representative BROWN. Thank you, Mr. Chairman. My time is up.

Senator BENTSEN. Next in the order of appearance was Congressman Wylie.

Representative WYLIE. Thank you very much, Mr. Chairman.

Mr. Carlson, I must say that I'm very familiar with your campaign to send 50,000 letters to Members of Congress. My constituents are coming through for you. I think I am something over 2,000 now, and they usually start out, "I'm mad. Interest rates are too high and I want you to bring them down."

What would you suggest that I do to bring them down?

Mr. CARLSON. I think you have a grand opportunity in the next 10 days. You will be voting on the first concurrent budget resolution. If you would stick with $563 billion instead of $568 or $569 for the remainder of this fiscal year, and $595 instead of $610 or $613 for the next fiscal year, you would change this imbalance that we have between fiscal and monetary policy, and you would cause, assuming the people thought your action was credible, you could cause a very major shift in the trend of inflation and interest rates.

This can have a much bigger impact than any other bailout approach, including Brooke-Cranston, that anybody is talking about.

Representative WYLIE. You know something? That's the way I'm answering my letters. I think too that when we balance the budget, that interest rates will come down. Do you agree with that, Mr. Partee?

Mr. PARTEE. I think it would help to have less credit demand, and the Treasury, if it balanced its budget, would be less in the market for credit.

Mr. CARLSON. However, I do think the tax burden is a reason for higher inflation. And by doing it by increasing tax receipts to a record increase in tax receipts for next year is the wrong way to go about it.

Representative WYLIE. Mr. Partee, hasn't the action of the Federal Reserve Board in raising interest rates really had an inflationary impact by increasing the cost of financing housing?

Mr. PARTEE. Congressman Wylie, let me correct the presumption of your question. We haven't increased interest rates. We have held back on the money supply. Interest rates are the price of money, and with a shortage of money relative to these very strong demands for it, the price has gone up—just as the price of coffee does if there's a strong demand for coffee relative to supply. It's a very free market for money.

There is no question in my mind that an increase in interest rates by itself adds to inflation. It adds to the CPI perhaps more than it should because of the way mortgage interest rates are dealt with; it adds to the cost of doing business; and it adds to the financing charges that people have to undertake.

But I corrected your question because I wanted to suggest to you that there is no easy answer. The only way that we might make an effort to keep interest rates from going up is to throw more money in—in other words, increase the supply. When the supply of money is increased, more generalized inflation results.

So the choice, I think, is between generalized inflation at an accelerating rate, and inflation in the rather narrow segment of the total mix of goods and services that is represented by debt.

Representative WYLIE. You said that you did not increase interest rates, that you are attempting to decrease the supply of money.

Mr. PARTEE. As you know, we have target growth rates for money and credit for the year that we presented to both the House and the Senate Banking Committees. What we are doing is trying to keep the growth in money and credit within those ranges that we gave which were supported by the Congress.

Representative WYLIE. So you're saying, then, that interest rates—this is the bottom line, that interest rates are due to inflation. High interest rates are due to inflation?

Mr. PARTEE. They are due to inflation, because people want to move their money into goods. They want to buy houses and cars instead of having money. That limits the savings flow. There was a question on savings earlier. It imbalances the economy and that leads to high interest rates.

Representative WYLIE. How much effect can consumer credit controls have on inflation?

Mr. PARTEE. Not very much themselves, Congressman Wylie. You need to look at the package of measures that the Federal Reserve announced on March 14 as attempting to do two things: one, limit the growth in effective credit demand to the supply that we were going to make possible—that is, the 6 to 9 percent; and second, establish

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to the maximum possible degree some equitable distribution of a scarce resource, credit.

Under the circumstances and given the generalized strength of consumer spending in the last several years, providing generalized purchasing power to people to buy a variety of goods was not a very productive way of using the scarce resource of credit; and, therefore, we put credit control on cash loans, credit cards, and certain other forms of consumer credit.

We didn't put it on home loans, home improvement loans, or loans to purchase cars, appliances, furniture or collateral of that kind.

Representative WYLIE. I take it then, Mr. Stephens, directing this at you, but it seems to me that the entire panel has agreed that the bottom line here to solve your problem and other people's problems and maybe the country's problems, is to balance the budget now; is that the way you feel?

Mr. STEPHENS. Well, most definitely I agree. I am concerned about two situations. One is the current situation. I guess we are looking for a quick fix or something to save what is left in 1980 before we don't have much of an industry left to save.

And the other is the long-term situation, which is exactly what you're saying. If we don't handle the balanced budget, we will not have any economic stability in the country, as you well know. If you can plan on Government spending and the rate of inflation of a certain percentage each year, that is stability.

I mean, what I was taught in college that slow creeping inflation wasn't too bad, but runaway inflation was. So yes, there is—otherwise, people would not buy a house if there wasn't any appreciation in the cost of it. And the appreciation is really based upon the replacement cost.

So the answer to your question, in the long-term result, yes. The balanced budget is probably one of the most—it creates an attitude just like the attitude I'm trying to create to get people back out to buy houses.

Representative WYLIE. Thank you very much, Mr. Chairman.

Mr. CARLSON. Mr. Chairman, may I just add to that? I think the move to put more monetary restraints, as opposed to doing something on the fiscal side, is clearly the wrong direction, because we really do have a bad mix of policy, too much restraint on the money growth. So that the proposal to put even more restraint on the monetary side was the exact opposite direction to go if you want to help this housing industry.

Senator BENTSEN. Senator McClure.

Senator McCLURE. Thank you, Mr. Chairman.

Mr. Stephens, in response to the question that Senator Bentsen asked earlier, which is causing you more trouble, higher interest rates or tight money, you commented about the impact of high interest rates. You did not respond to the other side of the question, of whether or not tight money supply, the lack of available capital, is your problem.

Mr. STEPHENS. We have plenty of funds that I know of right now around. It is just that you cannot afford them. If you want a loan, I can get you a loan anyplace. But you cannot afford it. You cannot even qualify for it and so therefore you can't get it.

Some of the institutions do not have it and they have restricted the growth. They are very careful about who their——

Senator McCLURE. But you can't qualify; it may be there but it is not available.

Mr. STEPHENS. That is correct. If we were to have a bust right now and a tremendous demand for loans and the interest rate would drop, yes, there would be a sorely lacking amount of money. But right now, with the present growth of housing, I believe there are funds available for it, but it is just unaffordable.

Senator McCLURE. Mr. Stephens earlier commented that apparently there is widespread agreement that we are fighting inflation with high interest rates. Mr. Partee, are we fighting—are the interest rates the results of policies designed to raise interest rates, or are interest rates high as a result of high rates of inflation?

Mr. PARTEE. As I said before, Senator McClure, it is the latter. The high rate of inflation makes people, businesses and others eager to borrow in order to finance a purchase today and beat the price increase. That unbalances the supply and demand situation for credit, and so the price goes up.

Senator McCLURE. Can you keep the interest rates below the rate of inflation?

Mr. PARTEE. It would be a race. More money could be provided. Instead of increasing money 3 to 6 percent or 3 to 6½ it could be increased by 6 to 10 percent. But that would soon result in a higher inflationary expectation, so the inflation would be 15 rather than 13 percent. I think that would be the way to hike the inflation.

Senator McCLURE. Mr. Partee, I'm a little confused to know who's going to lend money if they lend a dollar that is worth a dollar and they get back with interest $1.10, but by that time that dollar plus interest has a purchasing power worth $1.07. They have lost 3 cents, together with interest, over a year in total purchasing power. I don't understand how interest rates can run lower than the rate of inflation for very long.

Mr. PARTEE. I don't think they can for very long. They can do it in a weak economy.

Senator McCLURE. Doesn't capital then start looking for alternative places to place itself, such as gold, silver, commodities, fuels, rather than an interest rate of return? Isn't that correct?

Mr. PARTEE. Yes; people move from money to goods, exactly.

Senator McCLURE. Then what's the point in saying that we can keep interest rates below the rate of inflation? If, as a matter of fact, our policies drive the rate of inflation up, the interest rate must meet or exceed that rate of inflation in the long term.

Mr. PARTEE. I think over time that is quite true.

Senator McCLURE. Then the only way to get interest rates down is to cut inflation?

Mr. PARTEE. Absolutely.

Senator McCLURE. And we are only kidding ourselves in the aggregate if we say we can do differently than that?

Mr. PARTEE. I think that is right in the aggregate. Something could possibly be done for one industry.

Senator McCLURE. I want to get to that. Is there widespread agreement? I would judge that at least three of the four in the panel would say the housing industry is entitled to that kind of separate treatment. Do you agree that the housing industry ought to get that kind of separate treatment?

Mr. PARTEE. You are asking me?

Senator MCCLURE. Yes, sir. I expect the other three will say so.

Mr. PARTEE. As I said in my testimony. Mr. McClure, special short-term aids could be considered for housing. It is being hit very hard; but I think the discipline of the situation is that if the aid to housing is given, it will have to be taken away from something else because we can't afford to have larger budget expenditures or a larger Federal credit program. So it is necessary to find what it is going to be taken away from. Housing is being very severely hurt, more than other parts of the economy.

Senator MCCLURE. You haven't really answered my question, but I suspect that is about the way I would try to answer it, too.

Now, there are a variety of different ways in which we could get money into the housing industry—tax treatment of deposits that are designed toward the housing industry. What would be the result of passing legislation such as that which has been proposed, that would say that interest on those deposits which are directed toward the housing industry would be tax-free?

Mr. PARTEE. I think it would be very expensive, because there would be a substitution of funds that otherwise would have gone into the housing industry.

Senator MCCLURE. Well, how else do you pay for them?

Mr. PARTEE. There would be this substitution, so I think it would be very costly per dollar benefit. Earlier in the 1970's, there was a program of subsidized interest rates, contract interest rates for buyers who met the qualifications that the Government had set. I believe that is probably the cheapest way of aiding the housing area.

Senator MCCLURE. You mean you would subsidize them at less than the rate of taxation?

Mr. PARTEE. That is what you do; yes.

Senator MCCLURE. And therefore the savings would be the difference between the amount of subsidy and the amount of tax?

Mr. PARTEE. A contract is undertaken that will cost the Government money for each year into the future. That would be that difference in rates. If the Congress wanted to do something, it seems to me that this would be most cost efficient thing to do.

Senator MCCLURE. My 5 minutes is up. I hope to have another chance in a few minutes.

Mr. Chairman.

Senator BENTSEN. Well, we will go through the members again for those that have additional questions.

I just want to state once more, Mr. Partee, that I know of a lot of banks that tell me they have already had forward commitments in excess of 9 percent. So what you're talking about is no new loans by those banks. And I'm deeply, deeply concerned.

I just want to stress this. Big business will get their credit and small business will not and the homebuilder will not. And by the time you get the information back and run your records on what those banks are doing, I think a lot of them will be broke and out of business.

Mr. PARTEE. I understand the problem, Senator, and I agree with you in large part. It is very difficult to deal with. And even if we did succeed in cutting them off from the banks, the large corporations would find other sources of financing.

Senator BENTSEN. Sure, they can go to Eurodollars and other sources. But I really believe we are in a box. If we could feel that the burdens and the sacrifices are being equitably shared, then we could withstand them better. But I really don't believe they are.

And I would urge that you continue to try to find a way to see that the small businessman is adequately taken care of. Not just a recommendation on your part, but some way that actually diverts attention to them.

Mr. CARLSON. Senator Bentsen, I think that the situation we are in is man-made, not God-ordained, and consequently if we could reverse some of the bad policies that have come up with a very bad mix of economic policy that is collapsing the housing industry, you are going to help the small businessman, not only the homebuilder but other small business people too.

So trying to have credit allocation to overcome the problem is not any way to truly overcome this particular problem.

Senator BENTSEN. Mr. Carlson, we've got a short-term problem for some of these people and it's like that old story about the fellow that can't swim. They told him, don't worry about crossing that stream, it only averages 5 feet in depth. Well, it's the holes that get him. And that's what I'm concerned about for the small businessman.

Mr. CARLSON. May I just add one point. I think you have an opportunity in the next 10 days to vote on the first concurrent budget resolution. That could make more of a difference for the small businessman and homebuilder than any other action that Charles Partee or the Federal Reserve Board or the Congress could do.

Senator BENTSEN. Maybe. I'm not so sure that immediate direct correlation results.

Representative BROWN. Mr. Chairman, I just want to follow up, Mr. Partee, on the discussion that you were having with Senator McClure, because I thought it was most illuminating. I thought that you got right to the point, and neither one of you quite said it. And that is, where you have a 25-percent tax on inflation in the value of a Chinese vase, for instance, and a 30-percent tax on what you have got in the savings account, that is our problem, isn't it? The fact that it is better to bet on the value of the Chinese vase or an Oriental rug or a gold brick than it is to put the money in the savings account and give somebody the opportunity to build a house with it?

Mr. PARTEE. There are certainly a good many people that feel that way. I don't know if in the end it will turn out to be better or not for them, but they think that that is the case.

Representative BROWN. Well, most people, of course, can't sock it away in an Oriental rug or a Chinese vase. Most people have to put it aside for their own house or their own kids' college education or something else. And that is the problem, because we are taxing that kind of preplanning in terms of the average family needs, whereas we are encouraging people to put it in tax shelters.

And I find that to be historically and currently, if we keep doing it into the future, destructive of our society. The Germans, the Japanese, my God, even the British have discovered that if you reward people for investing it in the capital expansion of their society and the ability to produce in their society, they will have a stronger society.

And we are still saying, well, you know, you get out there and bet on inflation and you will make out. That's fine for people who have got the money to bet. But for those who just have to have it to live off of, now they are dipping into their savings and it's destroying them.

Mr. PARTEE. Congressman Brown, I agree with you that it is an inequitable situation. My question would be whether it is better to try to treat the equity problem by creating a new tax shelter or by reducing the rate of inflation, because I think reducing the rate of inflation would greatly add to the incentive to save.

Representative BROWN. But they go hand in hand, and that is the point I would like to make clear, and I think it is the point that Mr. Stephens understands, and that is that you don't have to have a depression to cure inflation.

I want you to continue to hold restrictions on the increase in the money supply. I don't want you to loosen up now and create a worse inflation. I mean, I never thought we could tolerate 20 percent, and maybe we can't, inflation for very long. But I sure don't want it to go to 30 the next time we peak out, because you know, 12 we thought was unconscionable the last time we peaked out. And so let's not go any further on this.

Let's control the money supply, but let's get these tax cuts to get some kind of a supply-side regeneration of our economy. And let's balance the budget in the meantime. So that we don't have the Federal Government competing in the economy.

Now, I just want to ask a question of all of you. Does anyone disagree that the idea of lowering Federal spending and borrowing—and this was Mr. Carlson's—to leave the limited amount of available credit to the private sector and localities is the right way to go at this time? Does anybody have any question about that?

Mr. JANIS. I think the issue of Federal spending is one that is part of a piece. It is a piece that involves a combination of monetary and fiscal policy.

Representative BROWN. Excuse me just a minute. But if you balance the budget, don't you at least get that Federal leviathan out of the credit market and leave it for the individual? Now would you agree with that or not?

Mr. JANIS. I think it is overstated, frankly, sir. I don't think $5 or $10 billion one way or the other makes an awful lot of difference in real terms, when you are talking about balancing a budget, when you're talking about deficits. What you are dealing with is an enormous perception problem, and the perception of Government getting—or the Federal Government getting its own house in order, and I think that perception is a very important thing.

Representative BROWN. In other words, the economics doesn't count; it's all cosmetic, it's all psychology?

Mr. JANIS. I think when it comes to $10 or $15 or $20 billion, I think we're talking about a relatively small sum of money in terms of the total credit picture.

Representative BROWN. What is big enough? $30, $40, $50, $100 billion, or $200 billion? Where is it where it suddenly gets to the size—I mean, here we've got a Federal Government that in 5 years has increased its income almost 100 percent; $360 billion in 1976, $600 billion in 1981. If you ran a business like that and were still losing money, you might be a whale of a marketing man, but you wouldn't be around running that business for very long. They would get rid of you.

Mr. JANIS. It seems to me that running a business, which I have done, is far different than running the Federal budget.

Representative BROWN. That may be the problem. Too many people in the Federal Government think that the Federal Government isn't like any other business. Well, it really isn't, you just manufacture the money.

But I mean, isn't that part of our problem?

Mr. JANIS. I think the problem is that the Fed was carrying the ball by itself, and I think it is a hero in this whole thing. I must tell you, although maybe that is an unpopular opinion among some. But I think they came in early and they said, we're going to get inflation under control, we're going to do it with every kind of tool that we have at our disposal.

Now, I think there is an obligation on the other side relative to the fiscal side, and I think Congress has got that obligation, as does the administration. And I think now Congress and the administration are both headed in the right direction relative to those kinds of fiscal constraints.

I think you are right about the need to balance the budget, perhaps not for the same reasons, but I think you are right. But I think it is part of the piece. And I would hate personally to see the Federal Reserve, at least in anybody's part, get any criticism for what it's done, because I think it did the right thing and it did it early on and recognized the problem when it needed to be recognized.

Representative BROWN. Let me just respond in 1 second. My time is up. I don't fault the Federal Reserve System for what they're doing now. I fault them for having done it a little late. I want the budget balanced. I want the taxes cut and the Federal Reserve System to keep on doing what they are doing. And if we had started that about 4 years ago, Mr. Stephens wouldn't have the problem he has now.

Senator BENTSEN. Thank you very much, Congressman.

Congressman Wylie.

Representative WYLIE. I want to agree with Mr. Janis when he said he feels that the Federal Reserve has been asked to carry too much of the load, and I said so to Mr. Partee when he was before the Banking Committee recently.

But I would like to say, do you think it was necessary for the Fed to become involved to the extent it did in credit controls?

Mr. PARTEE. Congressman Wylie, the effort was to get some distribution of credit along reasonable priority lines. That is why the consumer credit marginal reserve requirement and the marginal reserve requirement on the growth of money market mutual funds were imposed. And that is why we have the special credit program that asks banks to prioritize the way they look at their loan applications.

Credit could have been squeezed without the program. But it began to look to me, as we went through February and into March, as if limiting the supply of money and credit, and having the rationing taking place solely through higher prices—that is, rising interest rates—was going to end up with nobody in the country left borrowing except the big businesses and governments.

Governments you can't cut off, unless the Congress does it. Big business has the opportunity and ability to deal with these things. My Board member associates and I were afraid that there would just be totally inadequate credit for the rest of the economy—the builders, the agriculture people, the small businesses, the home buyers, and the users of consumer credit to buy goods. That is why we did it, sir.

Representative Brown [presiding.]. Mr. Partee, Senator Bentsen had to leave.

We are going to continue on the 5-minute rule and have one more round.

Representative Wylie. Well, in your discussions on the imposition of credit controls, did you discuss or do you personally foresee the imposition of further, more rigid controls over credit?

Mr. Partee. I don't think they'll be necessary, Congressman Wylie. Lately there have been indications of a decline in the demand for credit in the economy. Bank credit, for example, went up substantially less rapidly in March than it had done earlier this year.

As you know, in the last week, we have had a boom in the security markets—in the bond market, and in the short-term security markets—that suggests investors are now betting on weaker credit demand and lower interest rates in the future. If that is so, we certainly don't need anything at all in the way of additional rules. And, indeed, the rules we have may not be around for very long.

Representative Wylie. I noticed in one of your reports that about 3 percent of the disposable income in the country went into savings accounts or savings deposits last month, and you regarded that as alarming—or I regard it as alarming. Am I right in regarding that as an alarming trend?

Mr. Partee. The personal savings rate is just slightly over 3 percent. It's the lowest it's been in this country since the scare buying of the Korean war period. And the alarming thing about it is not only that you don't have the financing of investment, but that it indicates an attitude on the part of the public that they are better off in goods than in money and financial assets.

Representative Wylie. Now, I've been receiving a lot of letters protesting your proposal to withhold taxes on interest and dividends. Wouldn't that be counterproductive as far as encouraging people to save or put their money in savings accounts?

Mr. Partee. Well, Congressman Wylie, of course it wasn't the Board's proposal to withhold taxes on interest and dividends. I think it was proposed by the Treasury. I wouldn't think that it would have any great effect on savings incentive, assuming that people pay their taxes. If they pay their taxes that are due on the interest, there is no reason to think that they would be any worse off for the withholding.

Now, there is an administrative problem. It is burdensome and difficult to withhold taxes, and it seems to me that something needs to be done to find a way to reduce that administrative problem. I believe Secretary Miller testified on that yesterday and suggested a cutoff or something similar to that. But in the spirit of fairness, as a person who just filed my tax return for 1979, I would like to think that other people are paying the taxes that they owe.

Mr. Carlson. But there was an additional provision that would accelerate the payment and make it much earlier and thereby take $2 billion out of the marketplace and thereby reduce savings and investment bonds, so consequently it is anti-investment and antihousing to go ahead with that provision?

Representative WYLIE. Well, I do think it would create an additional paperwork burden, too, on banks and businesses. And that would cause an additional cost.

Well, my time is up. I thank you very much.

Senator McCLURE. The way Government fights inflation is to create more Government employment. We fight unemployment that way, too. We just get people out of productive enterprises and into Government, where they guarantee we won't produce anything. And that seems to me to be counterproductive.

You know, I tend to agree with you, Mr. Janis, that the $5 billion or $10 billion quarrel over whether it will be a deficit or a balanced budget in the range of $5 billion or $10 billion is quibbling, except in terms of perceptions.

The larger part of the problem though seems to me to be the increase in Government expenditures. If we quarrel over balancing the budget where $5 billion or $10 billion may be involved, but increase Government spending by $100 billion, it seems to me that the increase in spending is much more significant than is the degree of deficit or a balance in the budget; would you agree?

Mr. JANIS. Yes.

I would like to indicate also, Senator, that I do favor balancing the budget. I didn't want to indicate that I don't. I think at this particular time it is part of the total monetary and fiscal policy package that needs to be done.

Senator McCLURE. Talking to some friends of mine yesterday—and they are friends, in spite of the fact that they may be more cynical about things than I am—they suggest that the economy will be turned around by this fall, because balancing the budget is going to knock x percentage off the inflation rate. And I think most optimistic experts say that less than 2 or 3 percentage points of the rate of inflation will be directly affected by a balanced budget, with $100 billion of increased spending.

So we will get down from 18 percent, down to 15 percent or 16 percent by that means. And then we will—late in the summer, when the exigencies of the political season are upon us in a much greater way than they are now, Mr. Partee, the Federal Reserve will suddenly find because the budget was balanced and therefore the rate of inflation has started down, lo and behold, now we can ease the credit restraints and the money supply restraints, and there will be sufficient money to run all of these industries.

Mr. Stephens, you will feel better, because the rate of inflation is coming down, there is more money available, and all of a sudden everybody begins to have good expectations about the economy. And that will last at least through November. And who cares beyond that?

Now, first——

Representative BROWN. You're cynical. [Laughter.]

Senator McCLURE. I'm not cynical. [Laughter.]

I'm just repeating what some of my friends have said, and they are good friends in spite of that. [Laughter.]

Is there disagreement with the fact that a balanced budget—we're talking about a difference between $595 billion and $610 billion in expenditures—in those terms, will having achieved a balanced budget, regardless of what level it might be, knock 2 or 3 percentage points off the rate of inflation? Or do you believe it will be more than that?

Mr. PARTEE. I guess I have to respond to that. I think it will be far less than that. The direct effect would be much, much less. The balancing of the budget and the taking of the Treasury out of the borrowing market would help the interest rate picture, and it would help credit markets.

Senator MCCLURE. But if they are out of the bond market and not borrowing in it, they are just extorting the money ahead of time by the rate of taxation, what difference does it make?

Mr. PARTEE. It is necessary to look at that, and I agree with your point there, too. Senator McClure, one must look at total spending and total revenues and the proportion of the GNP that they constitute, and they have been rising over the last couple of years. That is inflationary, there is no question about it.

Senator MCCLURE. If we desire to allocate money to the housing market, if that is a conscious decision on our part, what is the best way for us to allocate money to the market?

We have looked at Brooke-Cranston; we've looked at various kinds of things that can be done in secondary mortgage markets to channel more capital, make more capital available.

Mr. Stephens somewhat indicates it isn't the capital availability problem, it is the cost of capital. Then Brooke-Cranston or secondary mortgage markets are not really going to affect that.

What we ought to be doing then is looking at how can we get the rate of interest down more rapidly in the housing industry than we can anywhere else? That means Federal appropriations and subsidized loans. It means perhaps a tax treatment of the money that would be put into savings that would be channeled into it so more people put their money there at lower rates of interest.

Isn't that a more effective way than looking at secondary mortgage markets?

Mr. JANIS. I think you're right. Senator McClure, that the key here is the interest rate. It's not the availability of mortgage credit.

I would point out, however, that Brooke-Cranston does knock down the rate. That is specifically the objective. It would knock it down by 2 or more percentage points. I think you could look at that as a possibility, and I think you would be quite right to look at various tax proposals that I have heard which would also knock down the rate.

Senator MCCLURE. Well, if we knock the rate down by 2 or 3 percentage points by any of these combinations, that is a lot less significant than the cutting of the rate of inflation in half; isn't that correct?

Mr. CARLSON. Yes.

Senator MCCLURE. Thank you.

Representative BROWN. Thank you very much.

I want to go back to—I said we would have one more round. And I hope we aren't keeping you beyond the time that you could stay.

Does anyone disagree with the fact that we have these high interest rates because of high inflation brought on by excessive money creation over the past several years? I mean, isn't that the fundamental cause that we have here?

Mr. PARTEE. I don't know that I would agree that it was due, in the first instance, to excessive money creation. I think that there have been many pressures on the economy that have contributed to the inflation—such factors as higher incomes, larger wage demands, more costly economic regulations by Government, and the oil price increases.

But I agree with you, Congressman Brown, that high interest rates are associated with the rate of inflation.

Representative BROWN. And that the current interest rates are really barely above the inflation rate?

Mr. PARTEE. I would have to take some exception to that. I know that is said, because you can look at the CPI and see that it is 17 percent and the prime is 20 percent, which is only 3 points difference. But I think that the proper comparison is with the expected longer-term inflation rate.

The actual inflation rate in January and February had a great deal of energy and price increase in it. Energy prices in those 2 months rose at a 60-percent annual rate, which is far above what it will do over the longer run. And mortgage interest rates also ran up strongly.

So I think the basic rate of inflation is several points lower than that—perhaps 12 or 13 percent at most. And in those terms we are now at a point where I believe we have quite restrictive interest rates in real terms.

Representative BROWN. Well, let me try one more—and that more money creation is not the answer to the current problem?

Mr. PARTEE. No, it definitely is not. I think it would just accelerate the inflation.

Representative BROWN. I had an exchange with Mr. Volcker earlier when he was before this committee, in which I asked him, "Would not having any Federal deficits and Federal borrowing make slower money and credit growth easier to bear and to stick with?"

And he said, "Yes."

And then I went on to say, "Do you view fiscal restraint as supportive of a policy of controlling money and credit growth, or as a substitute for controlling money and credit growth?"

And his response was supportive, for the reasons I think I tried to explain here, that we will maintain restraint to the extent that we reasonably can over the growth of money and credit. And that process is facilitated by restraint on the budgetary side. It will enable us to achieve that with less effects in the credit markets, less strains and tensions. But it is not a substitute for restraint on money and credit growth.

And then we went on to have this exchange. I asked him, "It seems to me that if the Fed creates $20 billion or $30 billion less new money each year, that this would not necessarily impose a hardship on the private or local government borrowers if the Federal Government had cut back its own spending, say $20 billion or $30 billion and therefore made less demands on the credit markets; is that correct?"

Mr. Volcker agreed.

Would you all agree with that?

Mr. PARTEE. Yes, I think it is right.

Mr. CARLSON. Yes.

Representative BROWN. OK.

Well, let me go on to a couple of other points quickly.

I indicated earlier that we need to address the basic cause in general terms, not put bandaids on each separate area of agony in the economy. Credit controls, it seems to me, and allocation of credit fly in the face of that general approach, to some extent. And I just want to say to you that I think credit restraint—well, I would ask the question this way: Can credit restraint really discriminate against credit cards without hurting housing and automobiles?

I had the occasion, with necessarily some frantic feeling in it this weekend, of going over some of my wife's credit card expenditures. I found out that several of those related to the house we have just purchased recently.

The point of it is that those credit cards were used for improvements of the house—insulation, some things of that nature.

Now, that, it seems to me, isn't exactly vacation kind of expenditures that you mentioned. And when you just simply put a control on credit cards, if it is spent at a building supply place, Hechinger's or somebody, you really are having an impact on an area that you don't want to have an impact on; aren't you?

Mr. PARTEE. Well, that is a mixed bag because, of course, credit cards by their nature are used for everything. The alternative, in the case of insulation purchase or storm doors, for example, is to sign a closed-end credit agreement with Hechinger's or other suppliers. And it would not be subject to the marginal reserve requirements.

So one would be able, when making that kind of an expenditure, to obtain credit for which the special marginal deposit requirement would not apply.

Representative BROWN. Let me just ask one other question. My time is up, but I want to get a comment from you, and anybody who would be kind enough to comment on this question.

We have been talking about considering redoing the CPI, the Consumer Price Index, because it has some things in it like housing that do not represent a true determination of what the inflation impact on the average person is. Is it appropriate perhaps, also, to look at things like the prevailing wage issue with respect to Davis-Bacon in this current circumstance, because a lot of that work is being done on the green market and it has no record. And maybe we are a little bit off on what the prevailing wage figures really are.

Would anyone like to comment on that question? You understand the nature of the question?

Mr. CARLSON. Yes, sir. I think that the Davis-Bacon experience and the data that we have shows that it is a cause of pushing inflation higher than it would otherwise be.

Mr. PARTEE. I would say, Congressman Brown, that this is one structural factor that adds to inflation. I remember Jack Carlson and I once served on a body together, and we reviewed a list of 65 things that the Government did that gave an inflationary bias.

And you will find in each one of those 65 cases that there is a very strong supportive group for continuing whatever it is that is being done.

Mr. JANIS. Let me be contrary, if I might, and disagree with my colleagues and perhaps with you, Congressman.

I think there are problems with Davis-Bacon, and they have to do with the administration of it and with the determination of what is the prevailing wage. I think that needs to be fixed. But I don't think that Davis-Bacon, per se, is inflationary. If administered properly, it is an appropriate law of Congress.

I have built under Davis-Bacon for many years. I understand it. I know how it works. And it has guaranteed for me, as a union builder for some 25 years, an adequate flow of labor supply. It has stabilized and made my product a lot better.

Representative BROWN. But some of these regulations, though, do have an inflationary impact.

Congressman Wylie.

Representative WYLIE. Congressman, I think you have had a good hearing. We do have a record that will be very informative to read. And I believe I will just leave it there. I have no further questions.

Mr. CARLSON. Congressman Wylie, may I just mention—you mentioned that you had received some mail indicating a wiser economic policy, and I wanted to assure you that the mail is not only coming to you. I just have a sample of about 20,000 pieces of mail that came for us to deliver to you and your colleagues to hopefully have you vote for a wiser, first concurrent budget resolution, slowing down spending by 2 percent.

And let me just put it on top of the table so you can see that it is here.

Representative WYLIE. I think we get the message.

Representative BROWN. I think you're going to get your picture in the paper, Mr. Carlson. [Laughter.]

If there are no further questions, and if none of you have any other bags of mail or comments you want to make, the committee is adjourned until the call of the Chair.

[Whereupon, at 4:30 p.m., the committee adjourned, subject to the call of the Chair.]

[The following questions and answers were subsequently supplied for the record:]

RESPONSE OF HON. J. CHARLES PARTEE TO ADDITIONAL WRITTEN QUESTIONS POSED BY SENATOR JAVITS

Question 1. To what extent do you believe that the administration's anti-inflation fight can continue to rely on the fine tuning of monetary and fiscal policies to the exclusion of structural economic adjustments? Doesn't this approach risk plunging the economy into a recession—one that could be much more serious than the "mild" version presently forecast?

Answer. I believe that it is not appropriate to characterize the administration's anti-inflation fight as relying on "fine tuning" of monetary and fiscal policy. To the contrary, the administration has spoken out in opposition to any premature shifting in fiscal policy in response to a possible weakening in economic activity; at the same time, it has supported the Federal Reserve's efforts to counteract inflation by a steady policy of monetary restraint. Moreover, the administration has indicated that it is committed to structural changes, for example, in the regulatory area, that will help to remove the inflationary biases in the economy; it also has expressed a desire to see changes in tax laws that will enhance incentives for saving and investment as soon as the overall budgetary and economic situation make it possible to undertake such measures without exacerbating near-term inflationary pressures.

Question 2. Have interest rates peaked? Is this presently easing a temporary or more long-term phenomenon? Does the Federal Reserve anticipate easing the credit curbs by early summer or when?

Answer. Market rates of interest have dropped substantially from their recent peaks. It is impossible to state with certainty whether this easing does represent a decisive cyclical or secular downturn in rates. Certainly, it has been our expectation that, as the Federal Reserve adheres to its plans for moderate expansion of the money supply, any softening of the public's demand for money and credit associated with a slackening in economic activity or a diminution in inflation and inflationary expectations would lead to some decline in interest rates. Recent events appear to accord with that expectation; we can only hope that we have turned the corner in defusing the inflationary expectations that have plagued the economy and financial markets. The Board does not have any set timetable for relaxing or removing the special credit restraints it imposed on March 14. It is our intention to move in that direction as soon as conditions in credit markets and the economy permit. We must be fairly certain that trends in money and credit clearly suggest that any financial impetus or support to inflationary pressures have been removed.

Question 3. What moves does the Federal Reserve intend to take to spread the burden of the present monetary restraint program more evenly? What are your views on the recent slump in the housing and auto industries? Are there any programs, particularly in housing, which could be implemented to assist the industry without excessively contributing to inflation? In your view, which would be the most cost-efficient to implement?

Answer. Our credit restraint measures of March 14, taken under the Credit Control Act, were intended to ease some of the relatively extreme impacts of needed general monetary stringency on certain sectors of the economy. As you know, for example, our consumer credit restraint program exempts auto- and housing-related credit, and our lending guidelines for banks and other institutions recognize the desirability of giving special attention to the needs of small business and agriculture. In addition, the System recently adopted changes in its discount window policy that are intended to provide greater assurance that small banks will be able to meet the normal seasonal credit needs of their small business and agricultural customers.

The housing and auto industries clearly are two areas of particular weakness in the economy currently. The causes of the weakness of auto sales are several, including among others the decline in real disposable personal income and the sharp increases in the price of gasoline. More recently, increased stringency in consumer credit undoubtedly has contributed somewhat to the reduction in demand for cars. The decline in housing activity is more clearly linked to financial conditions. Residential construction will always be relatively sensitive to changes in the cost and availability of credit because houses are long-lived assets involving large expenditures that usually cannot be covered by accumulated savings. Any effort to assist the housing sector, as I'm sure you recognize, will either shift the burden of restrictive monetary policy to other sectors or reduce the overall effectiveness of policy in restraining inflation, or both in some degree. Moreover, given the fungibility of credit, programs to channel additional funds to the housing sector are likely to result in only marginal increases in building activity. I do not have any specific recommendations for new programs to assist housing. I would hope that we will see an easing in the momentum of inflation and, consequently, in interest rates; this would provide a strong stimulus to homebuilding, given the favorable demographic factors underlying demand in the industry.

Question 4. Has your list of financially troubled institutions been growing in recent months? What is the long-term profitability outlook for financial institutions generally?

Answer. The list of banks requiring more than the usual degree of supervisory oversight has not lengthened recently. However, we are well aware that there are many banks and thrift institutions whose earnings have been adversely affected by the squeeze of rising costs of funds and more stable average returns on portfolios that contain fixed-rate, longer-term assets. While a significant number of institutions may suffer operating losses in the near term, capital positions generally should be adequate to absorb those losses with no serious threat to the viability of the institutions. Some institutions—especially firms specializing in consumer lending—are hindered by usury ceilngs and are experencing earnings pressures as a result. Over the long term, assuming that we are able to bring inflation down, financial institutions should be able to attain normal profitability—although it will be necessary for them to adjust to an increasingly competitive market environment.

HOUSING AND THE ECONOMY

WEDNESDAY, SEPTEMBER 17, 1980

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 3:10 p.m., in room 1318, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senator Bentsen.

Also present: John M. Albertine, executive director; Charles H. Bradford, minority counsel; Deborah Matz and Mayanne Karmin, professional staff members; and Betty Maddox, administrative assistant.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. This hearing will come to order.

We have had a series of votes on the floor of the Senate and some more probably will be underway before long. So I would hope that everyone will stay within their time limitations. If they don't, they will be speaking without someone chairing the meeting. For those of you who haven't watched these lights, I get a Pavolovian reaction to them, but the amber one says we are in session. One light is a vote, two lights is a recess, three lights is a live quorum, four lights is the end of the day's business, five lights, rollcall, six lights, end of the morning business, seven lights, and it's broken [laughter].

I am pleased to welcome these very distinguished witnesses this afternoon. We have some reasonably good news, in that we see some recovery in the housing market. But we are concerned that interest rates appear to be on the rebound. The prime rate is now in excess of 12 percent. It seems only a matter of time before mortgage interest rates start increasing again. In fact, California thrift institutions which account for some 25 percent of savings and loan mortgage lending, and generally initiate the nationwide trends, recently raised their mortgage rates above the 13-percent level. Mortgage interest rates peaked in April at over 16 percent. This time because they are starting from a very high base, we don't know how high the interest rates could go. But one thing we can be sure of is that if and when interest rates take off again, we know that housing starts will plummet.

I feel, as most economists do, that concentrating on the money supply is important. But obviously, you can't adjust money supply alone, because you get some reactions in the marketplace that sometimes are not foreseen. And so I think you have to approach increases in interest rates carefully, right at this time, particularly when we are teetering back and forth right on the brink of what we hope is a recovery. We could have a severe setback, which we would have, if we had a turnback in the housing market.

Moreover, while I am concerned about the housing industry and the thrifts which are also adversely affected by the slow- and no-growth housing sector, I am deeply concerned about potential home buyers and apartment renters. New rental units are becoming more and more scarce. Increasing costs are rendering homeownership unattainable to a majority of young American families. We are facing a very difficult situation.

I don't see a permanent solution in sight, and I certainly would welcome any suggestions that any of the witnesses might have in that regard.

Our first witness is Ms. Kallek, who is Associate Director for Economic Fields, U.S. Bureau of the Census.

Ms. Kallek.

STATEMENT OF SHIRLEY KALLEK, ASSOCIATE DIRECTOR FOR ECONOMIC FIELDS, BUREAU OF THE CENSUS, DEPARTMENT OF COMMERCE

Ms. KALLEK. Thank you, Mr. Chairman.

I am pleased to have this opportunity to offer the Joint Economic Committee a few brief comments to supplement our "Housing Starts" press release issued this afternoon at 2:15 p.m.

Senator BENTSEN. The press release, together with your prepared statement, will be printed in the hearing record.

Ms. KALLEK. Privately owned housing units were started in August at a seasonally adjusted annual rate of 1,399,000, up 12 percent from the July rate. This is the third consecutive monthly increase since the May 1980 low point of 906,000 units. However, the August rate is still 22 percent below the August 1979 rate of 1,788,000 and 31 percent below the 2,020,000 rate of August 1977. August 1977 had the highest annualized starts rate for any August in the current housing cycle. The activity during August through October of last year was relatively high and preceded the steep decline which began in November.

During the first 8 months of this year 787,800 housing units were started compared with 1,202,100 units during the same period in 1979, a decline of 34 percent. Starts reached a low point in May at the same level as in the previous housing cycle which bottomed out in February 1975. As you can see, the current housing cycle started its upturn in 1975 at a lower level than the previous one and also peaked out at a considerably lower level.

August starts were up from July in every region with the greatest strength shown in the West, up about 30 percent to a level of 360,000 units. Again the August levels are well below a year ago with the South showing the smallest decline, 8.7 percent. During the current downturn starts in the South have held up better than in the other regions.

Nationally, one-family housing units were started in August at a rate of 974,000, 12 percent above the July rate of 870,000 units, but 21 percent below the August 1979 rate of 1,237,000 units. Through August of this year 38 percent fewer one-family houses have been started compared to the same period in 1979.

Sales of new one-family houses rebounded sharply from the low annualized rate of 345,000 in April 1980 to 659,000 in July. The April rate was the lowest in the last 10 years and followed the sharp dropoff that began in November.

With the decline in sales, the increase in sales prices of new houses has moderated since last fall. The median price in the second quarter of this year was $64,600, compared to $63,500, $62,600, and $64,700 in the previous three quarters. During 1978, the median sales price ranged from $53,000 in the first quarter to $59,000 in the last quarter. These smaller increases during this past year are in part explained by a trend toward the construction of smaller houses. The average size of houses sold in the second quarter of this year was 1,680 square feet, 4 to 4.5 percent less than the 1,760 square feet reported in 1979 and 1,750 square feet reported in 1978. The percentage of houses sold with fireplaces, basements, or garages has also dropped.

There were 334,000 single-family houses for sale at the end of July, down 20 percent from the 416,000 units available 1 years ago. The inventory of one-family houses has steadily declined over the past year. The ratio of the number of houses for sale to houses sold for a month gives a useful measure of the number of month's supply at the month's current selling rate. Using this statistic, the number of month's supply of new one-family houses reached a peak of 12.6 percent in April 1980 as the sales rate dropped off sharply. This has been reversed in the the past several months as sales rebounded and inventories declined. By July, the number of month's supply for one-family houses had dropped to 6.2 percent.

Housing units in buildings with five or more units were started in August at a rate of 291,000 down slightly from July and 27 percent below the August 1979 rate of 399,000. Through August, 28 percent fewer multifamily units have been started in 1980 compared to the same period in 1979.

The highest level of multifamily starts reached in the current cycle was 462,000 units in 1978, about half the 906,000 started in 1972. Associated with the reduced level of apartment construction has been the increasing proportion of units built for sale. Condominiums accounted for 35 percent of new apartment units in the second quarter of 1980, as compared to a low of 13 percent in 1975 and 1976.

Statistics on building permits, an indicator of future construction, were also released this afternoon and showed an increase for the fourth consecutive month. New housing was authorized in August at a seasonally adjusted annual rate of 1,332,000 units, up 8 percent from July, but still 18-percent below the August 1979 rate of 1,622,000 units.

The number of one-family houses for which permits were issued in August was up 9 percent from July. However, there was virtually no change from July in the number of multifamily units—those in buildings with five units or more—authorized.

Regionally, increases in permit activity from July to August occurred only in the South and the West, up 14 percent and 7 percent, respectively. The level of permit activity in the South is almost back to where it was 1 year ago, but activity in the Northeast, North Central, and West is still well below the levels of 1 year ago.

I shall be pleased to answer any questions you may have.

[The press release referred to, together with Ms. Kallek's prepared statement, follows:]

[Bureau of the Census Press Release, Department of Commerce, Sept. 17, 1980]

Housing Starts and Building Permits in August 1980

PRIVATELY OWNED HOUSING STARTS

Privately owned housing units were started in August 1980 at a seasonally adjusted annual rate of 1,399,000 according to estimates reported today by the Bureau of the Census, U.S. Department of Commerce. This is 12 percent above the revised annual rate of 1,249,000 for July 1980, but 22 percent below the rate of 1,788,000 for August 1979.

The August 1980 seasonally adjusted annual rate for single-family housing starts was 974,000 compared with the revised July rate of 870,000 units. The rate in August for units in buildings with five units or more was 291,000 compared with the revised July rate of 298,000. The August rate for units in buildings with two to four units was 134,000. Housing starts do not include mobile homes. Mobile home shipments through July 1980 are shown in table 3.

During the first 8 months of this year, 787,800 housing units were started compared with 1,202,100 units for the same period in 1979, a decrease of 34 percent.

BUILDING PERMITS

New privately owned housing construction was authorized in August 1980 at a seasonally adjusted annual rate of 1,332,000 units in the 16,000 permit-issuing places. This is 8 percent above the revised rate of 1,236,000 for July, but 18 percent below the rate of 1,622,000 for August 1979.

New single-family units were authorized in August 1980 at a seasonally adjusted annual rate of 852,000 units compared with the revised July rate of 781,000. Units in buildings with five units or more were authorized in August at an annual rate of 340,000 compared with the revised July estimate of 336,000. The August rate of permit authorized units in buildings with two to four units was 140,000.

During the first 8 months of this year, 715,000 units were authorized by permits compared with 1,089,400 units for the same period in 1979, a decrease of 34 percent.

In interpreting changes in housing starts and building permits, note that month-to-month changes in seasonally adjusted statistics often show movements which may be irregular. It may take 3 months to establish an underlying trend for total starts and 2 months for total building permit authorizations.

The statistics in this release are estimated from sample surveys and are subject to sampling variability as well as errors of response and nonreporting. Estimated relative standard errors for preliminary data are shown in tables 1 and 2. An explanation of the reliability of the data appears in the appendix to Construction Report, C20–80–5.

TABLE 1.—NEW PRIVATELY OWNED HOUSING UNITS STARTED

[In thousands of units. Details may not add to table due to rounding]

Period	Total	In structures with— 1 unit	2 units	3 and 4 units	5 units or more	Region North-east	North central	South	West
Seasonal adjusted annual rate:									
1979:									
August	1,788	1,237	152		399	176	388	770	454
September	1,874	1,237	123		514	164	392	765	553
October	1,710	1,139	129		442	172	317	765	456
November	1,522	980	114		428	170	249	716	387
December	1,548	1,055	110		383	156	326	667	399
1980:									
January	1,419	1,002	127		290	194	218	673	333
February	1,330	786	101		443	73	223	1701	333
March	1,041	617	91		333	112	175	505	249
April	1,030	628	100		302	130	156	487	257
May	906	628	80		198	128	120	452	206
June[1]	1,223	757	75		391	120	179	679	245
July 1	1,249	870	81		298	114	193	664	278
August[2]	1,399	974	134		291	127	209	703	360
Relative standard error of preliminary estimates (percent)	4	3	6		13	12	9	6	6
Not seasonally adjusted:									
1979: August	170.3	119.4	6.1	6.9	37.8	19.9	38.1	71.9	40.4
1980:									
June[1]	116.4	76.9	3.3	4.2	32.0	13.2	20.8	58.0	24.4
July[1]	118.5	85.7	4.0	3.5	25.2	12.0	20.4	59.5	26.5
August[2]	126.9	89.2	5.0	6.1	26.5	13.1	19.3	63.3	31.2
Relative standard error of preliminary estimates (percent)	4	3	8	10	13	12	9	6	6
In 16.000 permit-issuing places—seasonally adjusted annual rate:									
1979: August	1,532	1,003	133		396	160	289	629	454
1980:									
June[1]	1,094	635	70		389	104	147	598	245
July[1]	1,117	743	78		296	103	161	575	278
August[2]	1,222	837	133		252	116	189	557	360
Relative standard error of preliminary estimates (percent)	4	3	6		12	11	10	5	6
In 16.000 permit-issuing places—not adjusted:									
1979: August	145.4	96.5	6.1	5.2	37.6	18.2	27.9	58.9	40.4
1980:									
June[1]	103.4	64.6	2.8	4.2	31.8	11.5	17.1	50.5	24.4
July[1]	105.4	73.1	3.9	3.4	24.9	10.8	16.9	51.1	26.5
August[2]	110.5	76.7	5.0	6.1	22.7	12.0	17.3	50.0	31.2
Relative standard error of preliminary estimates (percent)	4	3	8	9	12	11	10	5	6

[1] Revised.
[2] Preliminary.

Note: In addition, public housing starts for August 1979. June, July, and August 1980 (in thousands of units) were 1.1, 0.4, 0.6, and 0.4, respectively.

TABLE 2.—PRIVATELY OWNED HOUSING UNITS AUTHORIZED BY BUILDING PERMITS IN PERMIT-ISSUING PLACES

[In thousands of units details may not add to table due to rounding]

Period	Total	In structures with— 1 unit	2 units	3 and 4 units	5 units or more	Region North-east	North Central	South	West
Seasonally adjusted annual rate (16.000 permit-issuing places):									
1979: August	1,622	1,011	143		468	151	300	662	509
September	1,695	996	138		561	209	309	679	498
October	1,478	905	129		444	143	273	629	433
November	1,287	773	99		415	151	205	557	374
December	1,247	776	116		355	149	225	521	352
1980: January	1,271	780	119		372	108	212	592	359
February	1,168	708	111		349	132	192	524	320
March	968	556	94		318	133	129	449	257
April	789	473	63		253	86	116	385	202
May	825	495	81		249	98	122	399	206
June	1,078	628	93		357	114	142	534	288
July [1]	1,236	781	119		336	119	208	566	343
August [2]	1,322	852	140		340	113	205	647	367
Relative standard error of preliminary estimates (percent)	1	1	6		3	6	2	2	2
Not seasonally adjusted (16.000 permit-issuing places):									
1979: August	151.9	97.1	6.3	6.9	41.5	15.4	29.9	59.2	47.3
1980: June	101.3	60.6	4.2	4.2	32.3	11.1	14.7	48.4	27.1
July [2]	113.3	74.0	4.8	5.5	29.0	11.5	19.8	50.1	31.9
August [2]	113.5	74.4	5.5	6.5	27.1	10.5	18.8	52.9	31.3
Relative standard error of preliminary estimates (percent)	1	1	6	9	3	6	2	2	1
Not started at end of period—not seasonally adjusted (16.000 permit-issuing places):									
1979: August	221.9	101.5	16.0		104.5	37.1	26.2	94.8	63.9
1980: June [1]	168.6	74.6	12.7		81.3	31.7	18.0	79.5	39.4
July [1]	175.1	79.4	13.9		81.7	32.3	19.4	79.7	43.8
August [2]	176.6	76.9	14.9		84.8	29.6	21.2	83.4	42.4
Relative standard error of preliminary estimates (percent)	5	5	10	8	9	23	8	6	

[1] Revised.
[2] Preliminary.

TABLE 3.—MANUFACTURERS' SHIPMENTS OF MOBILE HOMES AND PRIVATELY OWNED HOUSING UNITS STARTED

[In thousands of units]

Period	Seasonally adjusted annual rate: Manufacturers' shipments of mobile homes	Single family structures started plus mobile home shipments	Total housing units started plus mobile home shipments	Not seasonally adjusted: Manfacturers' shipments of mobile homes	Single family structures started plus mobile home shipments	Total housing units started plus mobile home shipments
1919: July	295	1,517	2,059	22.4	140.2	186.6
1980: June [1]	163	920	1,386	15.4	92.3	131.7
: July [2]	215	1,085	1,464	17.0	102.7	135.5
: Aug	NA	NA	NA	NA	NA	NA

[1] Reviewed figures are for housing units started.
[2] Preliminary.
NA Not yet available.

Note: The statitics on manufacturer's shipments of mobile homes are provided by the National Conference of States on Building Codes and Standards (NCSBCS).

PREPARED STATEMENT OF SHIRLEY KALLEK

Mr. Chairman and Members of the committee, I am pleased to have this opportunity to offer the Joint Economic Committee a few brief comments to supplement our Housing Starts press release issued this afternoon at 2:15 p.m.

Privately owned housing units were started in August at a seasonally adjusted annual rate of 1,399,000, up 12 percent from the July rate. This is the third consecutive monthly increase since the May 1980 low point of 906,000 units. However, the August rate is still 22 percent below the August 1979 rate of 1,788,000 and 31 percent below the 2,020,000 rate of August 1977. August 1977 had the highest annualized starts rate for any August in the current housing cycle. The activity during August through October of last year was relatively high and preceded the steep decline which began in November.

During the first 8 months of this year 878,800 housing units were started compared with 1,202,100 units during the same period in 1979, a decline of 34 percent. Starts reached a low point in May at the same level as in the previous housing cycle which bottomed out in February 1975. As you can see from the data in Table 1, and Charts 1 and 1A, the current housing cycle started its upturn in 1975 at a lower level than the previous one and also peaked out at a considerably lower level.

TABLE 1.—NEW PRIVATE HOUSING UNITS STARTED

[In thousands of units]

Period	Total	In structures with— 1 unit	2–4 units	5 units or more	Region: Northeast	North Central	South	West
Annual data:								
1970	1,434	813	85	536	218	294	612	311
1971	2,052	1,151	120	781	264	434	869	486
1972	2,357	1,309	141	906	329	443	1,057	527
1973	2,045	1,132	118	795	277	440	899	429
1974	1,338	888	68	382	183	317	553	285
1975	1,160	892	64	204	149	294	442	275
1976	1,538	1,162	86	289	169	400	569	400
1977	1,987	1,451	122	414	202	465	783	538
1978	2,020	1,433	125	462	200	451	824	545
1979	1,745	1,194	122	429	178	349	748	470
Year to date:								
1979	1,202	851	82	269	116	241	515	330
1980	788	529	64	195	75	115	404	193
Percent change	−34	−38	−22	−28	−35	−52	−22	−42

August starts were up from July in every region with the greatest strength shown in the West, up about 30 percent to a level of 360,000 units. Again the August levels are well below a year ago with the South showing the smallest decline, 8.7 percent. During the current downturn, starts in the South have held up better than in the other regions.

ONE-FAMILY HOUSING

Nationally, one-family housing units were started in August at a rate of 974,000, 12 percent above the July rate of 870,000 units, but 21 percent below the August 1979 rate of 1,237,000 units. Through August, 38 percent fewer one-family houses have been started compared to the same period in 1979.

Sales of new one-family houses rebounded sharply from the low annualized rate of 345,000 in April 1980 to 659,000 in July. The April rate was the lowest in the last 10 years and followed the sharp dropoff that began in November. (See Chart 3.) The effective conventional mortgage rate on the purchase of new houses was still at a high level in August. On loans closed, the August 1980 rate was 12.24 percent according to the Federal Home Loan Bank Board.

With the decline in sales, the increase in sales prices of new houses has moderated since last fall. The median price in the second quarter of this year was $64,600, compared to $63,500, $62,600, and $64,700 in the previous 3 quarters. During 1978, the median sales price ranged from $53,000 in the first quarter to $59,000 in the last quarter. These smaller increases during this past year are in part explained by a trend towards the construction of smaller houses. The average size of houses sold in the second quarter of this year was 1,680 square feet, 4 to 4.5 percent less than the 1,760 square feet reported in 1979 and 1,750 reported in 1978. The percentage of houses sold with fireplaces, basements, or garages has also dropped.

There were 334,000 single-family houses for sale at the end of July, down 20 percent from the 416.000 units available a year ago. The inventory of one-family houses has steadily declined over the past year. The ratio of the number of houses for sale to houses sold for a month gives a useful measure of the number of month's supply at the month's current selling rate. Using this statistic, the number of month's supply of new one-family houses reached a peak of 12.6 in April 1980 as the sales rate dropped off sharply. This has been reversed in the past several months as sales rebounded and inventories declined. By July, the number of month's supply for one-family houses had dropped to 6.2.

MULTIFAMILY HOUSING

Housing units in buildings with 5 or more units were started in August at a rate of 291,000, down slightly from July and 27 percent below the August 1979 rate of 399,000. Through August, 28 percent fewer multifamily units have been started in 1980 compared to the same period in 1979.

The highest level of multifamily starts reached in the current cycle was 462,000 units in 1978, about half the 906,000 started in 1972. Associated with the reduced level of apartment construction has been the increasing proportion of units built for sale. Condominiums accounted for 35 percent of new apartment units in the second quarter of 1980 as compared to a low of 13 percent in 1975 and 1976.

TABLE 2.—HOUSING STARTS IN BUILDINGS WITH 5 OR MORE UNITS

[In thousands of units]

Period	Number of units started			Percentage		
	Total	For sale condominium [1]	For rent	Total	For sale condominium [1]	For rent
1970	536	NA	NA	100	NA	NA
1971	781	NA	NA	100	NA	NA
1972	906	NA	NA	100	NA	NA
1973	795	NA	NA	100	NA	NA
1974	382	104	278	100	27	73
1975	204	26	178	100	13	87
1976	289	38	251	100	13	87
1977	414	57	357	100	14	86
1978	462	89	373	100	19	81
1979	429	126	303	100	29	71
1980: 1st quarter	67	23	44	100	34	66
2d quarter	76	26	49	100	35	65

[1] Includes a small number of units to be cooperatively owned.

BUILDING PERMITS

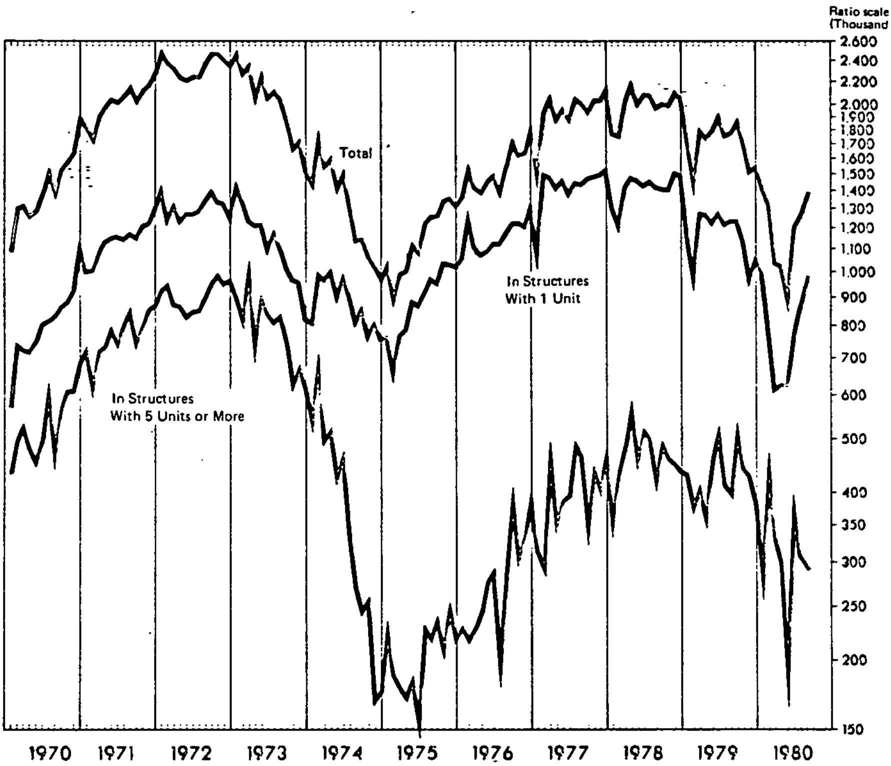
Statistics on building permits, an indicator of future construction, were also released this afternoon and showed an increase for the fourth consecutive month. New housing was authorized in August at a seasonally adjusted annual rate of 1,332,000 units, up 8 percent from July, but still 18 percent below the August 1979 rate of 1,622,000 units.

The number of one-family houses for which permits were issued in August was up 9 percent from July. However, there was virtually no change from July in the number of multi-family units (those in buildings with 5 units or more) authorized.

Regionally, increases in permit activity from July to August occurred only in the South and the West, up 14 percent and 7 percent, respectively. The level of permit activity in the South is almost back to where it was a year ago, but activity in the Northeast, North Central, and West is still well below the levels of a year ago.

My colleagues and I will be pleased to answer any questions you may have.

CHART 1. New Private Housing Units Started
Seasonally Adjusted Annual Rate



Note: Total includes units started in structure with 2 to 4 units

CHART 1A Comparing Housing Starts From 1970 to 1975 to Those From 1975 to Present
(Seasonally Adjusted Annual Rates)

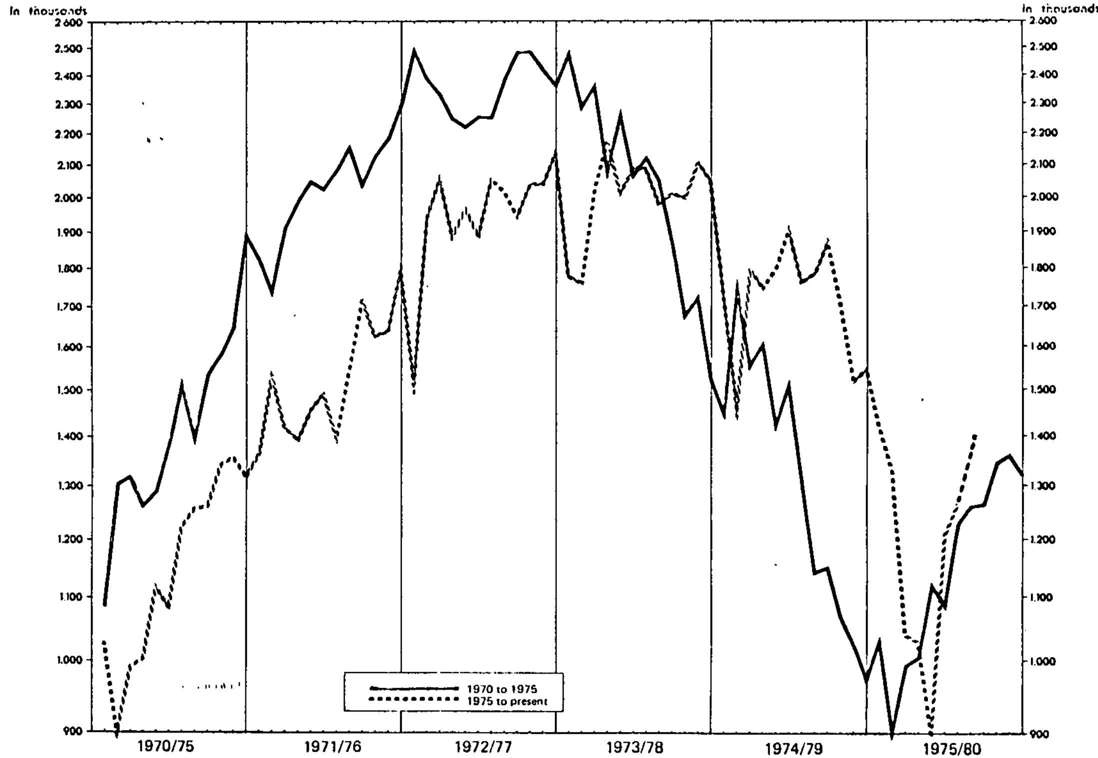


CHART 2. New Private Housing Units Started

Seasonally Adjusted Annual Rate

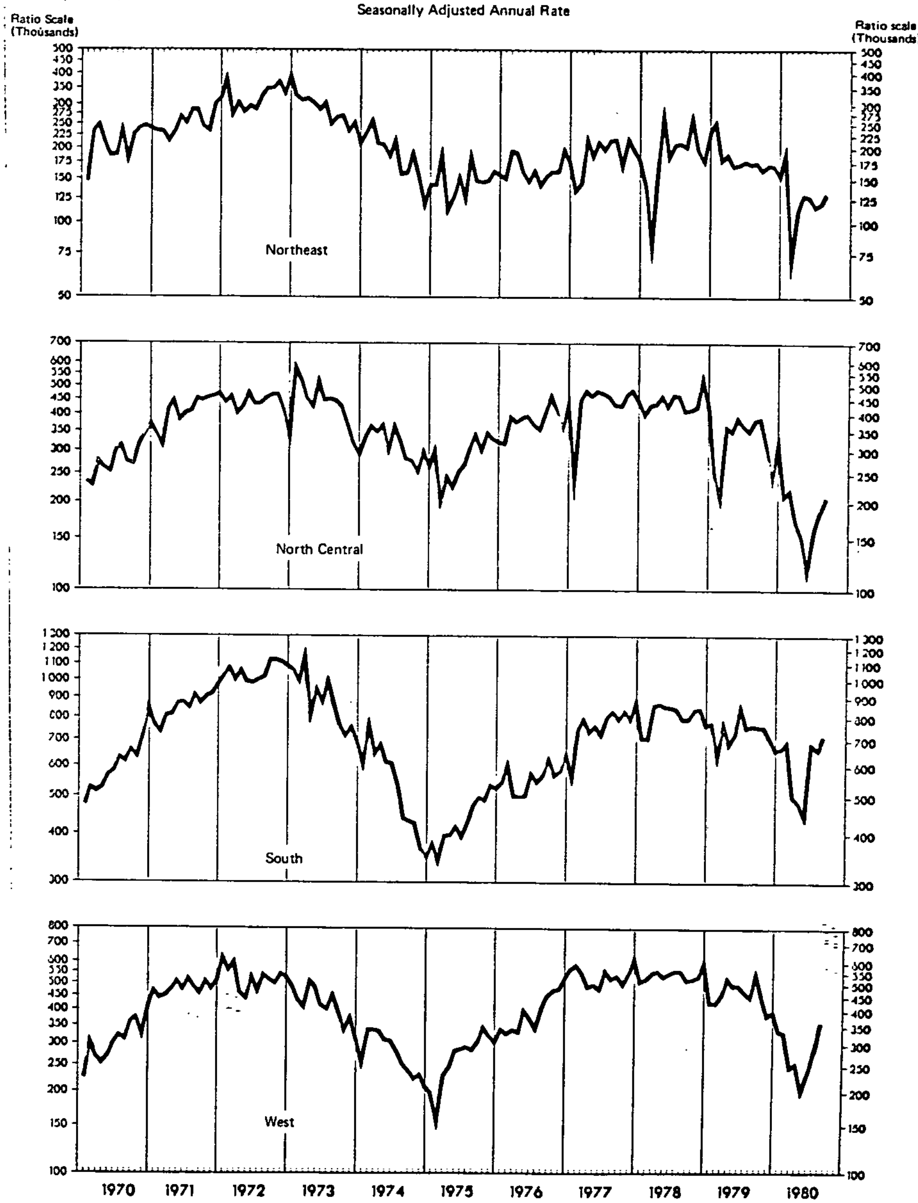
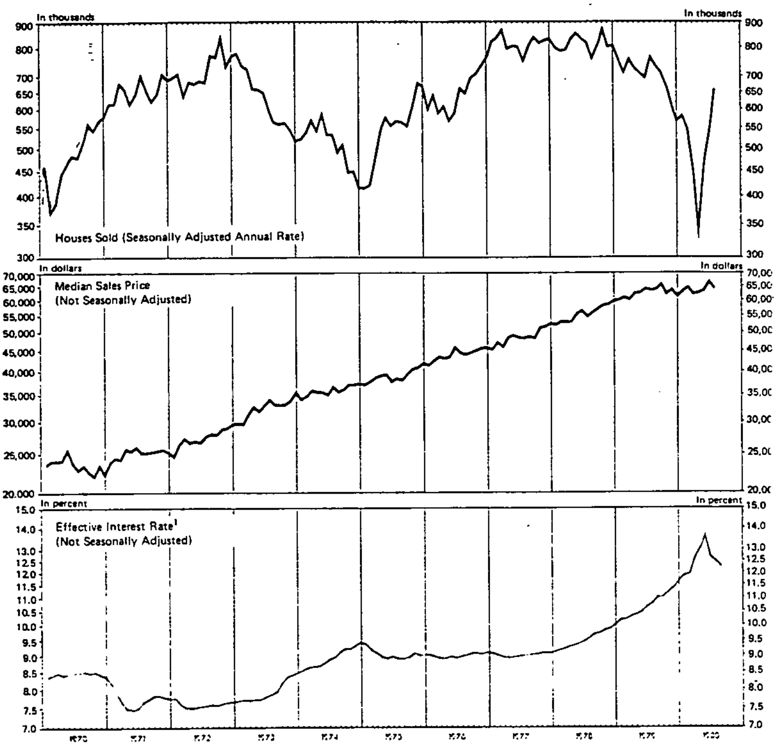
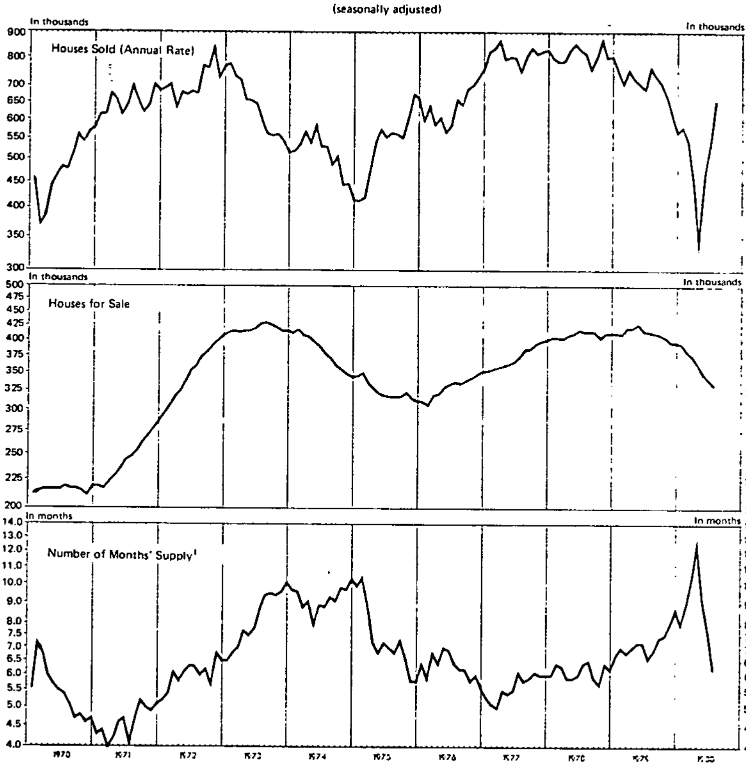


CHART 3. New One-Family Houses Sold, Median Sales Prices and the Effective Interest Rates



[1] Source: FHLBB

CHART 4. New One-Family Houses Sold, For Sale and Months' Supply at Current Sales Rate
(seasonally adjusted)



¹ Ratio of Houses for Sale to Houses Sold at Current Sales Rate

Senator BENTSEN. I will proceed with the witnesses, because of our time problems, and will get back to questions later.

We are very pleased to have Herman J. Smith, who is the vice president of the National Association of Home Builders, and incidentally, an old friend of mine.

STATEMENT OF HERMAN J. SMITH, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, WASHINGTON, D.C., ACCOMPANIED BY ROBERT D. BANNISTER, SENIOR VICE PRESIDENT FOR GOVERNMENTAL AFFAIRS; AND MICHAEL SUMICHRAST, CHIEF ECONOMIST

Mr. SMITH. Thank you, Mr. Chairman.

If you will permit me, I will submit my prepared statement for the record and just briefly comment and hold within my allotted time.

My name is Herman J. Smith, and I am a homebuilder from Fort Worth, Tex. I am testifying today on behalf of the more than 122,000 members of the National Association of Home Builders, (NAHB), who employ over 3 million workers. NAHB is the trade association of the Nation's home building industry, of which I am first vice president.

Accompanying me today are Robert D. Bannister, senior staff vice president for governmental affairs, and Michael Sumichrast, chief economist.

Mr. Chairman, I am very pleased to appear before your distinguished committee this afternoon to discuss the short-term outlook for housing and to examine the existing and emerging problems for the housing industry—and the housing consumer.

At the outset, let me say that we have reviewed your committee's midyear report on the recession and the recovery. It is a unique achievement that this committee has been able to reach a bipartisan consensus on long-term policies to increase our Nation's productive capacity in the midst of this hotly contested election year. But, in a sense, it should not be so surprising.

Your basic premise reflects simple logic—inflation and unemployment require long-term solutions to promote, as you stated, "greater and more efficient production." As the representative of the industry which has been at the cutting edge of each of the 7 recessions within the last 35 years, we enthusiastically endorse the principal message in your annual report: "America does not have to fight inflation during the 1980's by periodically pulling up the drawbridge with recessions that doom millions of Americans to unemployment."

Mr. Chairman, the Federal Government could make no greater contribution to housing the American people in the 1980's than by putting the economy on a steady, predictable growth path which will create jobs and help hold down price increases by allowing us to provide sufficient housing to meet the growing demand in this decade.

I am aware that it is not very productive to engage in a lengthy recitation of "I told you so's" as the economy begins on the slow path to recovery. But I feel constrained to briefly sympathize with this committee. I know that in June 1979, you and Representative Brown jointly urged enactment of a supply stimulus for businesses and individuals to encourage savings, improve productivity, and enhance economic growth. I wish, as we look back a few months ago, this could have been accomplished, and I believe we would have been down the road toward recovery.

Housing represents a productive investment which creates employment and increases Federal and local revenues. And I believe that a healthy housing industry is an essential element in providing the impetus for a national economic recovery.

Mr. Chairman, it has been said that when the economy has a cold, the housing industry gets pneumonia. There is no doubt that our industry was taken to the emergency room when the Federal Reserve Board acted last October, and again in February. And, frankly, there were a few months when we thought that the patient's condition was terminal.

But I must candidly say that we have witnessed a reasonably strong rebound in June, July, and up to mid-August. But as the charts in my prepared statement on monthly housing starts and sales—exhibits A and B—show, we have a long way to go toward recovery. What I fear most today is that the patient may be suffering a relapse. Unless there is a decline from the sharp increases in interest rates of the last few weeks, we could have one of the shortest housing recoveries on record.

The latest Freddy Mac auction—exhibit E in my prepared statement—show yields at 13.6 percent.

If you don't mind, Mr. Chairman, I wish we could turn to exhibit E. I need to add the September 16 figure at the bottom of the list. That figure is 13.817 percent and includes the service charge. You will note the increase from the September 9 figure to 13.649 percent.

Now, if we look back up exhibit E to June 24, we see a bottoming out at 11.973 percent. In all fairness to the reports you are receiving from governmental agencies, I am thinking these are the reports we are now looking at.

Based on the cost today, we are going to see starts for the month of September and for the month of October sizably down. In fact, I have been in Fort Worth, Birmingham, and Atlanta in the last 3 days, and I can tell you they are not starting new houses with the discount going from 12 percent FHA loan at 13. They are now starting new housing conventionally with the housing rate at 13¾ percent.

The chart on the wall behind you lacks about 2 or 3 more inches up above that question mark of getting back up to where it is as of today. These wild swings are causing another downturn in housing. We are going to see some reports on this next month, and I think they are going to surprise some people.

Analysis of the reports from the field shows clearly that the lower end of the market financed by FHA and VA has been hit hard by cancellation of commitments by mortgage bankers as well as cancellations of sales. As noted in the last few days, Mr. Chairman, even in my part of the country—where the time of difference from when the buyer, a young couple, enters into a contract to purchase a house, is given the application for loan, and 2 or 3 weeks later closes out the loan—that monthly payment has been known to jump in the last few weeks as much as $30, $40 to $50 a month. In some cases——

Senator BENTSEN. Wait a minute now. Restate that again. You say during the time——

Mr. SMITH. The interest rate has jumped so much in the last few days. If we look at the Freddie Mac auctions, we see what's happened. The interest rate has jumped so much at times from the time this couple enters into an application to purchase a house, and their loan application is taken, and credit reports and other data come forward. They are anticipating an interest rate of a certain amount, and a monthly fixed payment of a certain amount.

But in the last few weeks we have seen such a change in the upward turn of interest rates—because of the cost of money—that we have seen, No. 1, a sizable increase in the monthly payments, or, No. 2, their inability to qualify for the loan at closing. It's rather sad to go down to close and see a young couple who cannot consummate their transaction because in the last few weeks the interest rate has gone up to the point it's not available.

I don't think this is necessary but it's one of the problems we are putting up with today. This rather pessimistic outlook only underscores the importance of the restoration of a stable economic climate.

In my prepared statement I refer to the emerging problems for the housing industry. Let me say I believe you and this committee are familiar with the demographics for the 1980's and I will not get into the details except to point out our exhibit F shows the addition of 23 million housing units and how they would be established.

On rental housing we have noticed that the prices in rental housing and inability of the private sector to develop and operate such housing in today's market will mean that, unless new incentives are provided, rental housing will not be able to meet any substantial portion of the existing demand.

In my prepared statement I also refer to cost problems; about the alarming statistics of the increase in costs, and, in one item, we have noted that in our opinion the median price of a new home could reach $100,000 by 1984.

It refers also to some legislative recommendations pertaining to the tax cut. We have testified to your committee before on this subject, and the tax incentives for savings. We appreciate your concern, Mr. Chairman, in the years gone by, and efforts you have made in this area. I will just say we fully concur, so I will not have to elaborate.

Then we have mentioned our concern pertaining to rental housing and the measures to reduce the cyclical nature. We share the views expressed in this committee's report pertaining to the stimulus programs, activated too late in the recession cycle to have the desired countercyclical effect. I think we saw some evidence of this in the last 6 or 8 months.

We hope Congress will consider an automatic triggering mechanism for emergency housing assistance so we do not enter into the problem of trying to cure it after the fact.

I have been given a note that my time is up. I could talk at length on this subject. We share your concern. Our prepared statement and the charts, I believe, are self-explanatory and I stand ready to answer any questions you may have at the conclusion, Mr. Chairman.

Thank you very much.

Senator BENTSEN. Thank you very much, Mr. Smith.

[The prepared statement of Mr. Smith, together with exhibits A–G, follows:]

PREPARED STATEMENT OF HERMAN J. SMITH

Mr. Chairman and members of the committee, my name is Herman J. Smith, and I am a home builder from Fort Worth, Texas. I am testifying today on behalf of the more than 122,000 members of the National Association of Home Builders, (NAHB), who employ over 3 million workers. NAHB is the trade association of of the nation's home building industry, of which I am first vice president. Accompanying me today are Robert D. Bannister, senior vice president for governmental affairs and Michael Sumichrast, chief economist.

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At the outset, let me say that we have reviewed your Committee's midyear report on the recession and the recovery. It is a unique achievement that this Committee has been able to reach a bipartisan consensus on long-term policies to increase our nation's productive capacity in the midst of this hotly-contested election year. But, in a sense, it should not be so surprising. Your basic premise reflects simple logic—inflation and unemployment require long-term solutions to promote "greater and more efficient production." As the representative of the industry which has been at the "cutting edge" of each of the seven recessions within the last 35 years, we enthusiastically endorse the principal message in your annual report—"America does not have to fight inflation during the 1980's by periodically pulling up the drawbridge with recessions that doom millions of Americans to unemployment." And, may I add, that will deny millions of low-income, moderate-income, and even middle-income Americans the opportunity of decent, affordable shelter and the dream of owning a home of their own.

Mr. Chairman, the Federal Government could make no greater contribution to housing the American people in the 1980's than by putting the economy on a steady, predictable growth path which will create jobs and help hold down price increases by allowing us to provide sufficient housing to meet the growing demand in this decade. Of course, there will still be a need for special assistance for certain segments of the market such as low-income housing, multifamily rental production, and first-time homebuyers. In those areas as well, a steady and predictable level of Federal support would go a long way to ensure reasonable progress toward our national goal of a decent home for every American family.

Mr. Chairman (and Representative Brown), I am aware that it is not very productive to engage in a lengthy recitation of "I told you so's" as the economy begins on the slow path to recovery. But I feel constrained to briefly sympathize with this Committee. I know that in June 1979, Chairman Bentsen and Representative Brown jointly urged enactment of a supply stimulus for businesses and individuals to encourage savings, improve productivity, and enhance economic growth. I agree with Representative Brown's assessment that we could have avoided the worst of our current economic crisis and would have built a solid base for growth—if only the advice of this Committee had been heeded by the Administration and the Congress. My personal view is that if the Administration and the Congress had reacted to our industry's warnings last October and enacted an emergency home purchase assistance program—as was done in 1974–75—along with the general savings and productivity measures urged by this Committee, I would be coming here today with a much more optimistic short-term outlook. And, equally as important, our nation would be on the path to steady and predictable growth in the 1980's. Enough of hindsight. As Dr. Sumichrast, our Chief Economist has said, it would be easy to forecast—if only we did not have to predict the future.

IMPACT OF HOUSING ON THE ECONOMY

I am aware that this Committee recognizes the importance of the housing industry to our nation's economy. The numbers help put it in perspective. The housing industry is one of the largest contributors to the Gross National Product, and new residential construction accounted for about 4.8 percent of the GNP in

1979, representing 114.1 billion. Housing production has a powerful ripple effect throughout the economy, creating jobs and stimulating sales and demand for goods and services. The total economic impact of the 1979 production rate of 1.74 million new housing starts has been estimated to be in excess of $210 billion. The production of 1.74 million new housing units has generated more than 2.5 million full time jobs; some $45 billion in wages; over $5 billion in Federal income tax revenue; about $2 billion in local real estate tax revenue; and an additional $850 million in state income tax. This represents a tremendous contribution by an industry whose members are predominantly small businessmen and women who build an average of about 15 new homes a year. Housing represents a productive investment which creates employment and increases Federal and local revenues. And I believe that a healthy housing industry is an essential element in providing the impetus for a national economic recovery.

HOUSING OUTLOOK

Mr. Chairman, it has been said that when the economy has a cold, the housing industry gets pneumonia. There is no doubt that our industry was taken to the emergency room when the Federal Reserve Board acted last October and again in February. And, frankly, there were a few months when we thought that the patient's condition was terminal. But, I must candidly say that we have witnessed a reasonably strong rebound in June, July, and up to mid-August. But as the attached charts on monthly housing starts and sales (exhibits A & B) show we have a long way to go toward recovery. What I fear most today is that the patient may be suffering a relapse. Unless there is a decline from the sharp increases in interest rates of the last few weeks, we could have one of the shortest housing recoveries on record.

In June and July, interest rates declined sharply after reaching their alltime historical high. During that period, the decline in housing starts and sales began to reverse. Sales of less expensive homes financed under FHA and VA were to a large degree responsible for this recovery. I must add that this recovery has not been uniform throughout the country. In some areas of high unemployment and stagnant economic conditions, such as the mid-West and New England, housing starts and sales remain severely depressed despite the reduction in interest rates. During this period, car sales and retail sales improved while unemployment hovered just under 8 percent. But we perceive a renewed weakness which has developed in the last four to five weeks as a result of the escalation in interest rates. Housing sales have already been hit by about a 200 basis point increase in interest rates (exhibit C). And any significant reduction in rates in the near future seems very unlikely. In our opinion, housing will have to improve in order for the national economy to recover.

Our latest housing starts forecast calls for fewer than 1.2 million housing starts (single and multi-family) in 1980 and 1.49 million starts in 1981 (exhibit D). But recent trends in interest rates raise the question of whether even these low levels will be reached. Out latest estimates indicate the possibility of a loss of 50 to 75,000 units this year and another 170 to 200,000 units next year from the forecasted levels.

The latest Freddy Mac auction showed yields at 13.6 percent (exhibit E). Similar sharp increases in FNMA & FHA yields have resulted in a serious decline in volume. It is clear that there is little demand for 14 percent mortgages.

This increase in mortgage rates has already had an impact on sales, although this has not yet been reflected in published data. Our analysis of reports from the field shows clearly that the lower end of the market—financed by FHA loans and VA guarantees—has been hard hit by cancellations of commitments by mortgage bankers as well as cancellations of sales. Back in mid-March, 90 percent of the builders responding to our survey reported "poor" sales. By late August, this was reduced to 50 percent. A telephone survey taken about a week and a half ago shows an increase to 63 percent—a substantial jump in such a short period of time.

At the same time, the unemployment rate among construction workers continues to rise. In August it reached 18.3 percent—934,000 people out of work. This compares with July's 16.1 percent or 807,000 unemployed. And these figures represent only wage and salary workers—they do not include the independent firms, self-employed, and contract workers.

Mr. Chairman, we are facing the possibility of a return to the scenario of last October and this spring. We see little hope of a decline in interest rates by this October or November. We do not see steady or predictable growth in the economy or stability in prices generally. This will make it extremely difficult to sell and produce the housing needed by the American people.

This rather pessimistic outlook only underscores the importance of the restoration of a stable economic climate. Three times in less than one year, we have seen interest rates rise and fall so sharply and so rapidly that it seems virtually impossible to sustain any level of stability in housing production. Only a few years ago, a rise in mortgage rates of 200 basis points took place over a period of 2 years. Today, it seems that it only takes a matter of a few weeks. It seems clear that some fundamental changes are needed in order for our industry to function as the provider of needed housing and a major contributor to our national economy.

EMERGING PROBLEMS FOR THE HOUSING INDUSTRY

What does the industry face as we begin to recover from one of the most severe downturns in history?

Housing demand

First, the underlying demand for housing is very strong and will grow substantially through the decade of the 1980's. Projections indicate that during the 1980's, 41 million Americans will reach the prime homebuying age of 30. This compares with about 31 million who will have reached the age of 30 during the 1970's. The rate of new household formation will be 25 percent higher in the 1980's than during the last decade.

This increased rate of family formation is largely the result of the postwar baby boom and the number of increased single person households. We predict that there will be no significant drop in housing demand until the 1990's, when the "baby bust" generation of the 1960's enters the housing market.

When combined with the number of families currently occupying substandard housing and the number of housing units removed from the market each year by demolition, disaster, or other means, an additional 23 million housing units would be needed during this decade (Exhibit F). The demand for housing would not even be met by a level of production of 2 million units per year, which has traditionally been considered a "very good year" for housing. And any lower production levels will almost certainly result in increased upward pressure on home prices due to the simple facts of supply and demand.

Rental housing

Second, the crisis in rental housing and the inability of the private sector to develop and operate multifamily housing in today's market will mean that, unless new incentives are provided, rental housing will not be able to meet any substantial portion of the existing demand. In fact, as many potential new homebuyers are being priced out of the homeownership market, there has been a shrinkage in the available inventory of rental apartments nationwide. This gives young families increasingly limited choice in meeting their housing needs.

Let me just briefly outline the problem. The numbers are quite startling. Statistics compiled by NAHB's Economic Department show that in the last three years, the annual net loss of rental inventory has been about 1½ percent. Last year, the loss of rental units exceeded the number of new units constructed by about 200,000.

Equally as troubling is the low level of privately financed multifamily construction. In 1979, of about 430,000 multifamily rental units built, only about 210,000 were privately financed. Over 50 percent of the units were subsidized low and moderate income housing and FHA-insured multifamily housing. At the same time, losses to the inventory in 1978 due to demolition, fires, and abandonment totalled about 400,000.

It is evident that high interest rates, increased operating costs and the expansion of rent controls and regulation of condominium and cooperative conversions have all but dried up the private market in rental housing construction. Existing tax incentives are no longer sufficient to stimulate rental construction. In addition, several provisions added in the 1976 Tax Reform Act are major disincentives to the development of new multifamily rental housing.

At the same time, demand for multifamily housing is high. The nationwide multifamily rental vacancy rate fell below 5 percent in 1979, according to Census Bureau statistics—the lowest figure since this statistic was first compiled 20 years ago. After removing substandard units and second homes, the effective vacancy rate is about 2 to 3 percent. A vacancy rate over 7 percent is essential in order to provide for reasonable mobility in housing. In addition, there continues to be a substantial unmet need for housing for the elderly, large families, newly-forming households, and for replacement of older declining housing stock.

A General Accounting Office report on rental housing released on November 8, 1979 found that the shortage of affordable rental housing is so acute that immediate Congressional action is needed. GAO found that multifamily starts in the private sector last year were at their second lowest rate in 20 years. They projected that this year the private sector would provide only about 25 percent of the new rental units, and that most of these would be for high-income tenants. The 75 percent of the starts which are financed by government represent a troublesome trend and a tremendous increase over the 22 percent government share of starts in 1972 and 44 percent in 1978. In fact, while the government-aided share has increased over the past few years, the actual number of units produced has declined.

Housing costs

A housing cost crisis of unknown proportions threatens to engulf American society in the 1980's. It threatens to divide our society, separating those who have already realized the American dream of owning a home from those who will be denied affordable housing in the future. It is an issue that pits one generation of Americans against another. It is a crisis that further penalizes those who are most vulnerable in our society—the young, the elderly, and the poor.

The statistics are alarming. If present trends persist, the median price of a new home will reach $100,000 by 1984. Since the end of 1974, the median price of new housing has increased by over 75 percent, from $36,000 in 1974 to over $63,000 today. In many metropolitan areas, a modest three bedroom home now costs well over $80,000. In sharp contrast, median family income rose only 48 percent during the same five-year period and consumer prices as a whole increased by only 47 percent.

The cost of building new housing is not likely to recede or even moderate significantly during this decade. In 1979, building materials prices went up another 8 percent, despite the 15 percent decline in housing production. Land and land development costs continued to soar. The cost of a developed lot now accounts for between 20 and 30 percent of the purchase price of a typical new home.

Another inflationary factor that cannot be ignored is the effect of the deregulation of depository institutions and the phaseout of Regulation Q on the cost of housing. I testified before the House Banking Committee on this issue last month. Just as interest rates were beginning to decline, the actions of the Depository Institutions Deregulations Committee effectively imposed a floor on mortgage interest rates by establishing an artificial minimum rate for 6 month and 30 month savings certificates. This certainly inhibited the housing recovery, and assured that mortgage interest rates would not drop below 11 percent.

Part of the housing cost problem can obviously be attributed to the general rate of inflation which has been pushing up the cost of virtually everything. Housing's boom-and-bust cycles are extremely disruptive and are in themselves inflationary. They have reduced productivity in housing by disrupting management and decimating the supply of skilled construction labor. In addition, they make rational planning by suppliers extremely difficult. During periods of slack construction, plant and equipment stand idle; the capacity for manufacturing materials and components used in housing construction is underutilized; and construction workers are not employed. During periods of high construction activity, workers demand higher wages to provide reasonable annual incomes (considering periods of unemployment); returns on plant and equipment must be higher to make up for losses during idle periods; and the demand for resources used in housing is increased sharply. This results in higher land prices, higher material prices, higher interest costs, and higher wage costs.

Excessive governmental regulations and long delays involved in the governmental review process are another major cost problem for builders and potential home buyers. There are three basic regulatory problems. First, there are the obvious no-growth policies that reduce the supply of available land, thereby pushing up the price of remaining parcels of land still available for residential development.

In a sense, this problem pits existing residents against newcomers. Existing residents want to protect the value of their property. They don't want to be bothered with the problems of growth—the increases in school enrollments and traffic and the other strains on public facilities and services that new growth eventually brings.

Since existing homeowners are the established voters in the community, public officials often fall into line, implementing zoning and growth policies and development fee schemes that restrict the number and types of new housing that can be built in their community.

Newcomers are then pushed to bordering communities, which must assume a greater share of the growth burden in the region, or to undeveloped, outlying areas where completely new road systems, schools, sewer and water treatment plants, and other public facilities must be constructed at a much greater cost—economically, environmentally, and from an energy standpoint.

Consequently, the price of raw land has soared. Unreasonable zoning and growth policies that restrict the supply of available land for development are primarily responsible for this sharp escalation in land prices.

Excessive land development, subdivision and construction standards and fees are the second major regulatory problem confronting home builders. The General Accounting Office recently surveyed eleven metropolitan areas, including 87 individual jurisdictions, to determine the extent of the problem. That study concluded that the more restrictive communities had: (1) excessive standards for streets and related site improvements that could increase the cost of a typical home by as much as $2,655; (2) requirements for 100 to 200 foot wide lots that further increased the cost of each home; (3) requirements for dedicating land for parks and schools costing up to $850 per house; (4) municipal fees as high as $3,265 a house for such items as local reviews, permits, inspections, and utility connections; and (5) approval processes that took as long as 21 months before a builder was permitted to start construction.

To a certain extent, the sharp increase in land development costs reflects a major shift in local policies. Until recently, the community as a whole was willing to pay most of the cost of providing new public services and facilities or upgrading existing facilities on the theory that these new facilities benefitted all community residents—existing residents as well as newcomers. Now, however, more communities are forcing new home buyers to pay a much greater share or all of the cost of providing these new facilities. Consequently, fees, standards, and requirements are inflated. For example, builders in some areas are required to construct light traveled subdivision streets to interstate highway standards. That ensures a minimum of repair work on those roads for the local community over the next 10 years. Or the municipality may charge $2,500 or more for each home connecting into the sewer and water lines, when the actual cost of connecting that new home is a few hundred dollars. In addition, builders are re quired to dedicate land for schools, open space, and other public facilities. All these costs are passed on to new home buyers, even though the new or upgraded public facilities serve the entire community.

The third major regulatory cost problem is caused by the long delays in receiving permit and building plan approvals through the dozen or more agencies with some authority in the development process. Often there are conflicts between two agencies on a certain standard or requirement, creating what builders term the "pinball" effect as the developer is bounced from one department to the other in an attempt to reach some suitable compromise. In addition to the frustration, this is a very costly, time-consuming process that can add thousands of dollars to the cost of building a new home.

In 1960, it took about 12 months for a builder to complete the first home in a subdivision after purchasing the raw land. Now it can take as long as 3 years or longer to obtain all the necessary approvals before beginning construction. Unfortunately, the longer it takes to develop a parcel of land and build the homes, the greater the cost to the home purchaser.

MORTGAGE FINANCE

Major changes are occurring in the cost and availability of mortgage finance. In the past, financial institutions had a pool of 5-percent and 5¼-percent savings deposits upon which they could draw to finance mortgage loans. This provided mortgage financing at the lowest possible interest rates to home buyers. However, the passage of the Depository Institution Deregulation and Monetary Control Act of 1980 will bring on a new era in mortgage finance. Regulation Q, which prescribed the 5-percent and 5¼-percent interest rate ceiling, is to be phased out within 6 years. At that time, there will be no ceilings on the interest rates financial institutions may pay for their savings deposits. To be competitive and to attract savings, financial institutions will be required to pay prevailing market interest rates. If market interest rates are, for example, 9½ percent, then it will not be possible for financial institutions to make mortgage loans at interest rates below 11 percent or 11½ percent. These are likely to be minimum interest rates, and mortgage rates will probably fluctuate above that level.

What this means is that despite the overwhelming need and demand for housing, increasingly fewer families will be able to afford a median-priced new home. Exhibit G shows the effects of higher interest rates on housing affordability. Assuming a $65,000 house, with a 5-percent down payment, and a 30-year fixed rate mortgage period at 9 percent interest, the monthly principal and interest payment would be $497 and the annual income necessary to afford the house would be just over $34,000. At 12 percent interest, the principal and interest payment jumps by $138 a month to $635, and the annual income needed to afford the house increases to $40,800. Assuming the same $65,000 house with a 5 percent down payment, the increase in interest rate from 9 percent to 12 percent eliminates more than 4 million households from the ability to purchase that home.

We must look to innovative new mortgage instruments such as graduated payment mortgages, renegotiated rate mortgages and other instruments which are just being developed to help bridge the affordability gap. We must actively work to promote the secondary mortgage market and encourage investment by the multi-billion dollar pension funds, life insurance companies, and other nontraditional investors. In addition, some form of assistance should be devised to help the first-time homebuyer to accumulate the funds needed to purchase a home. Finally, I know that many members of this Committee are actively working for legislation which will increase the rate of savings through tax incentives so that the thrift institutions will continue to be able to serve as the principal mortgage lender.

LEGISLATIVE RECOMMENDATIONS

1. Tax cut

A tax cut must be targeted and structured in a way to avoid inflationary pressures. It should be directed toward improving business productivity and creating jobs. For the housing industry, a tax cut should be structured to accomplish two results: (1) to provide a stable source of single family home financing at interest rates which families can afford and (2) to stimulate the production of multi-family housing. Accomplishing these objectives will create employment and moderate inflationary pressures on home prices by allowing the production of housing to better meet demand.

(A) *Tax incentives for savings.*—In testimony before the Senate Finance and House Ways and Means Committee, we urged support for legislation which would provide a tax exemption for interest on savings deposits used by financial institutions for residential mortgages (S. 2560, introduced by Senator Nelson). We also supported a bill to provide for tax-exempt housing savings accounts to assist first-time homebuyers in accumulating the downpayment on a home (S. 2745, introduced by Senator Dole). There are a number of other proposals which would reduce taxation on savings, such as Representative Brown's bill, H.R. 6400, which are worthy of your consideration.

(B) *Tax-exempt revenue bonds.*—NAHB believes that revenue bonds offer one of the tools which should be used to provide mortgage financing at affordable interest rates. Revenue bonds provide cities, counties, and states the opportunity of tailoring mortgage financing to the needs and demands of those individual jurisdictions. And we believe no one is in a better position to assess the needs and demands of local communities than the state of local government. We have urged that a tax cut bill include a provision permitting the issuance of tax-exempt revenue bonds after December 31, 1980. We would support either Senator Williams' bill (S. 2064) with the amendment introduced by Senators Randolph and Byrd, or the bill introduced by Senator Hart (S. 2746). Both the Williams bill and the Hart bill recognize that state housing finance agencies are responsible entities, strictly supervised by their state legislatures. Both bills recognize that the lending programs of state housing financing agencies generally are subject to income and mortgage limits developed by the state. These limits are carefully drawn to the needs of each state and represent the particular conditions in the state.

If restrictions are to be placed on cities or counties, then we would support either the Randolph/Byrd amendment to the Williams bill or the approach taken in Senator Hart's bill. The Randolph/Byrd approach provides that revenue bond financing can only be provided to families with incomes which do not exceed 45 percent of the average new one-family housing cost for the state in which the residence is located. The advantage of this approach is that it ties income levels to the actual cost of housing within each individual state. It does not set some arbitrary income level for the entire country which may or may not work in individual states.

Senator Hart's bill requires that families have an income not exceeding 150 percent of the median income for the statistical area in which the residence is located. If a fixed income limit is to be used, Senator Hart's approach makes good sense. With housing costs continuing to rise, this type of income limit permits the sale of some of the less expensive newly constructed homes, in addition to existing homes. A lower limit would almost surely prevent the sale of newly constructed houses.

(C) *Rental housing.*—Mr. Chairman, you are well aware of our support for S. 2969, which provides a comprehensive package of reforms to stimulate the production of rental housing. We are very pleased that you were able to include a 20/15 year straight line depreciation provision in the Senate Finance Committee tax package. This proposal would greatly simplify and give certainly to the depreciation process. We would strongly urge repeal of Section 189 of the Internal Revenue Code in order to allow deduction of construction period interest and taxes in the year in which the payments were made. As current and short-term expenses, these items should not be capitalized and should be treated as they are in other businesses. Finally, we believe that provisions for rapid amortization of expenditures for rehabilitation of low-income housing, historic preservation, and removal of barriers for the handicapped and elderly should be extended indefinitely. These provisions, which are due to expire, have proven their worth and help to promote important housing and social objectives.

2. Other measures to reduce cyclicality

We share the views expressed in the Committee's report that frequently governmental stimulus programs are activated too late in the recession cycle to have the desired countercyclical effect. In fact, some programs have been criticized for their substitution effect. The fault, however, does not lie in the programs but in the inability of government machinery (the Administration and Congress) to move rapidly enough to provide assistance as well as the inability to anticipate the need for such assistance. We would urge consideration of an automatic triggering mechanism for emergency housing assistance. In fact, such a trigger was proposed by Senator Proxmire back in 1975 in the Senate version of the Emergency Housing Act. It provided that emergency mortgage assistance would be automatically activated of housing starts fall below a 4-month moving average annual rate of 1.6 million units for four consecutive months. (This idea was revived by Senator Heinz in this year's housing bill as a "negative trigger" for the Brooke-Cranston Program.) Such a "trigger" could automatically activate a program such as Brooke-Cranston, an expanded use of tax-exempt revenue bonds, or a tax credit for the purchase of a new home, as well as an expansion of the Section 234 Homeownership Program.

3. Assisted housing

As I stated earlier, there is a great need for a stable and reasonable level of assistance for rental and homeownership assistance for low- and moderate-income families and the elderly, both in urban and rural areas. The supply of decent rental housing, particularly for large families and low-income people, is so limited that only increased production will begin to reduce the inflationary impact on rents. The rural housing situation in both owner-occupied and rental units is even below the record low vacancy rates of our urban centers. Because of severe savings outflow and traditionally limited credit availability in rural areas, moderate- and even middle-income families are unable to obtain financing from private conventional sources.

RECOMMENDATIONS TO THE JOINT ECONOMIC COMMITTEE

Mr. Chairman, we are very impressed with the work of this Committee under your distinguished leadership and with the assistance of your highly capable and talented staff.

I would like to conclude by making some recommendations as to areas which we believe would be fruitful for the Committee to pursue in the year ahead.

First, a good deal has been written recently about the cost of seasonal cycles in the housing industry. I would particularly recommend "seasonal Cycles in the Housing Market" by Professor Kenneth Rosen of the University of California at Berkely and a study by the Department of Labor issued in April 1979 on "Social Costs of Instability in Construction." Both of these analyses reveal seasonal fluctuations in employment and construction output of real significance. This instability only increases the pressure on housing prices as well as unemployment. Professor Rosen recommends consideration of an incentive to stimulate winter employment in housing construction as was tried in Canada and Norway in the 1960's. These programs provided a flat grant to the first purchaser of a home built primarily in the winter months. While NAHB has not taken a position on such form of assistance, I believe it is worthy of your review and analysis.

Second, because of our great concern about meeting the demand for housing in the 1980's, we would urge this Committee to reexamine the various needs analysis of single-family and multi-family housing for this decade. It is only by such an objective evaluation that responsible housing, tax, and economic policies can be developed for both government-assisted and privately-developed housing.

Finally, this Committee would perform an inestimable service if you could help devise a rational system for budgeting Federal housing programs. It has been our concern that reflecting the entire long-term budget authority for assisted housing programs in a single year's budget puts housing at a serious disadvantage in regard to other budget priorities. We are aware of no other major Federal programs that are accounted for in this manner. Others have maintained that the authorized budget authority may not be sufficient to meet the full-term of commitments. Inexplicably to us, the Brooke-Cranston Program is budgeted as a full-cost, long-term item even though the Federal Governmnt recovers a substantial portion of the assistance through eventual sale of the mortgages—and may even result in a positive return to the government. This problem has unfortunately been with us since the 1974 Budget Act and is long overdue for reasoned analysis.

CONCLUSION

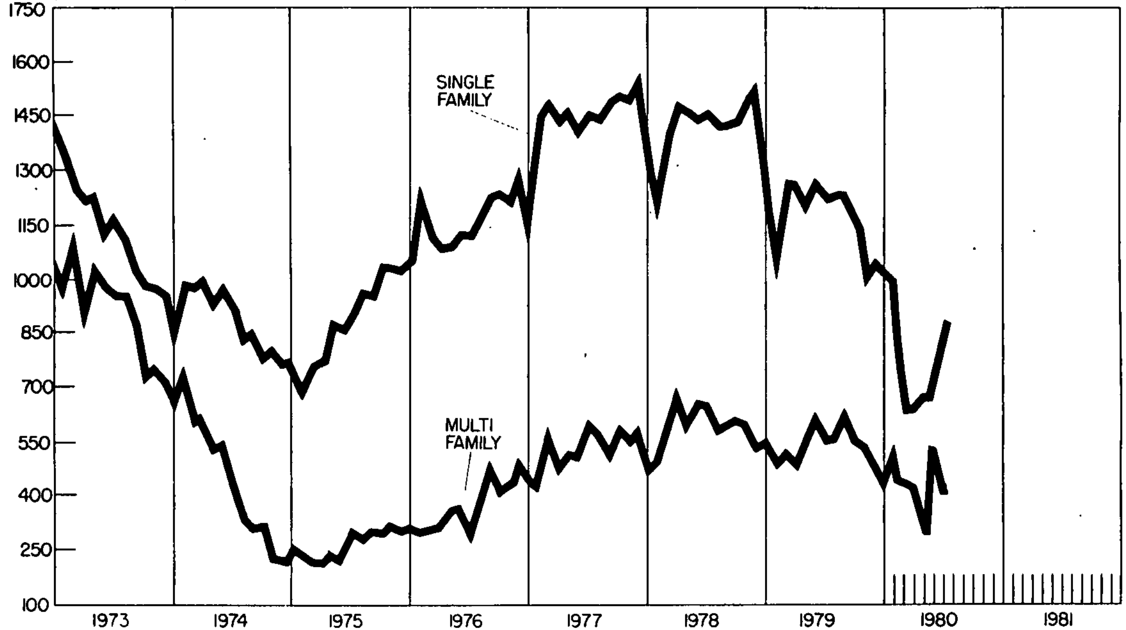
Mr. Chairman, I apologize for the length of this statement. Perhaps the downturn in housing has given us both the time and the impetus to reflect on the future of our industry and our ability as a nation to house upcoming generations of Americans.

I am sincerely grateful for the opportunity to appear before you today. I would be pleased to answer any questions you may have.

SINGLE VS MULTI-FAMILY PRIVATE HOUSING STARTS

EXHIBIT A

(IN THOUSANDS) SEASONALLY ADJUSTED ANNUAL RATES

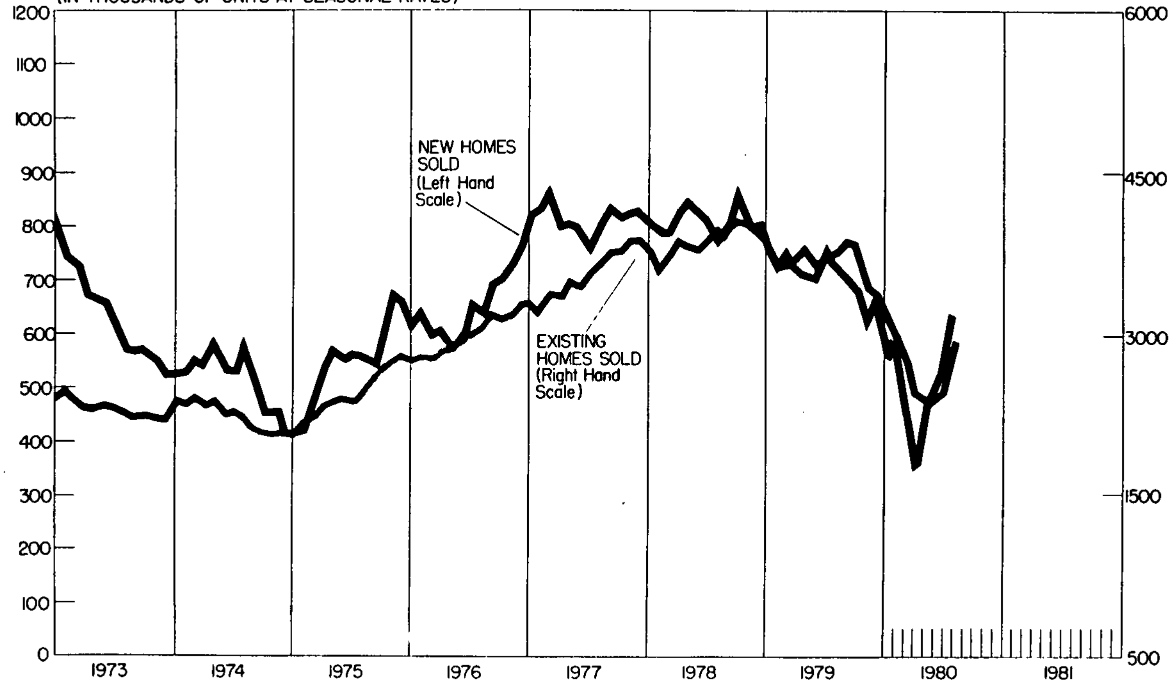


SOURCE: BUREAU OF THE CENSUS.

SALES OF NEW AND EXISTING HOMES SOLD

EXHIBIT B

(IN THOUSANDS OF UNITS AT SEASONAL RATES)



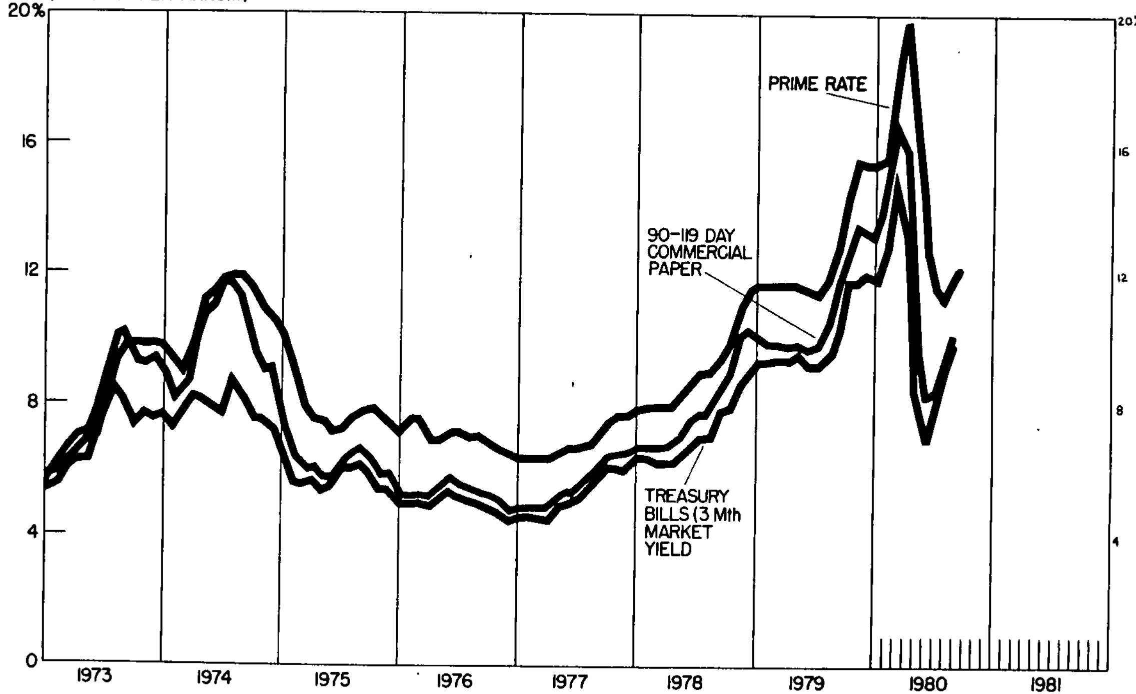
SOURCE: BUREAU OF THE CENSUS, NATIONAL ASSN. OF REALTORS

72-946 0 - 81 - 7

SHORT TERM INTEREST RATES

EXHIBIT C

(PERCENT PER ANNUM)



SOURCE: FEDERAL RESERVE BOARD.

EXHIBIT D

1980 AND 1981 HOUSING STARTS FORECASTS USING 3 DIFFERENT INTEREST RATE SCENARIOS

[In thousands]

	1980 (quarter)				1981 (quarter)					
	1st	2d	3d	4th	1st	2d	3d	4th	1980	1981
Housing Starts—SAAR:										
Scenario I:										
Total	1,220.5	1,025.6	1,241.0	1,355.1	1,511.5	1,479.6	1,514.9	1,495.2	1,175.1	1,487.9
Single family	765.2	673.2	654.7	843.2	1,010.3	997.2	969.1	952.1	715.3	997.6
Multifamily	455.3	352.4	586.3	511.9	501.2	482.4	545.8	543.1	459.8	510.3
Scenario II:										
Total	1,220.5	1,025.6	1,241.0	1,341.9	1,455.0	1,391.4	1,401.1	1,372.6	1,147.8	1,391.6
Single family	765.2	673.2	654.7	833.1	968.2	930.6	879.5	851.3	699.9	850.3
Multifamily	455.3	352.4	586.3	508.7	486.8	460.8	521.6	521.3	447.9	471.5
Scenario III:										
Total	1,220.4	1,025.6	1,241.0	1,329.6	1,417.4	1,342.1	1,332.8	1,243.9	1,144.0	1,321.8
Single family	765.2	673.2	654.7	823.6	940.0	893.1	829.2	756.7	696.8	850.3
Multifamily	455.3	352.4	586.3	505.9	477.3	449.0	503.6	487.2	447.2	471.5
Interest rates (percent):										
Scenario I:										
3-mo T-bills	13.35	9.62	8.60	8.20	7.95	7.95	8.00	8.25	9.94	8.04
Prime rate	16.40	16.32	11.25	11.00	10.75	10.75	11.00	11.25	13.74	10.94
AAA bonds	12.14	11.20	11.00	10.75	10.50	10.50	10.60	10.80	11.27	10.60
Scenario II:										
3-mo T-bills	13.35	9.62	8.60	8.60	8.60	8.60	8.00	8.00	10.04	8.30
Prime rate	16.40	16.30	11.25	11.25	11.25	11.25	11.50	11.50	13.81	11.38
AAA bonds	12.14	11.20	11.00	11.00	11.00	11.00	11.25	11.50	11.34	11.19
Scenario III:										
3-mo T-bills	13.35	9.62	8.60	8.85	8.85	8.85	9.25	9.25	10.11	9.05
Prime rate	16.40	16.30	11.25	11.50	11.50	11.50	11.75	11.75	13.87	11.63
AAA bonds	12.14	11.20	11.00	11.25	11.25	11.25	11.50	11.75	11.40	11.44

Source: NAHB Econometric Forecast Service, August 1980.

EXHIBIT E

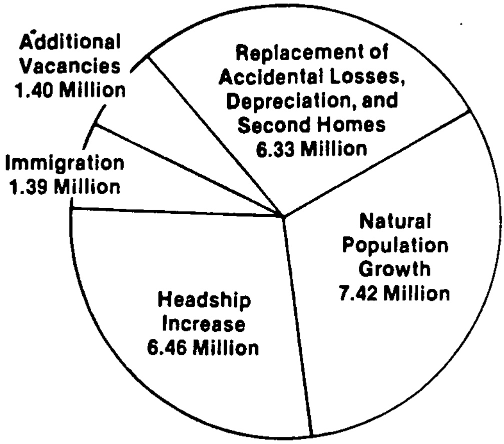
FREDDIE MAC YIELDS

Date	Percent: With service charge (0.375)	Percent: Without service charge
1979:		
Nov. 7	13.934	13.559
Nov. 14	13.598	13.223
Nov. 21	13.377	13.002
Nov. 28	13.269	12.894
Dec. 4	13.068	12.693
Dec. 11	12.879	12.504
Dec. 17	12.886	12.511
Dec. 26	12.848	12.473
Dec. 31	12.898	12.523
1980:		
Jan. 7	13.006	12.631
Jan. 14	13.063	12.688
Jan. 21	13.139	12.764
Jan. 28	13.176	12.901
Feb. 4	13.428	13.053
Feb. 11	13.624	13.249
Feb. 19	13.852	13.477
Feb. 27	14.474	14.099
Mar. 5	14.812	14.437
Mar. 12	15.712	15.337
Mar. 19	16.535	16.160
Mar. 26	16.590	16.215
Apr. 2	16.426	16.051
1980:		
Apr. 9	16.155	15.780
Apr. 18	15.096	15.531
Apr. 23	15.412	15.037
Apr. 30	14.890	14.515
May 7	13.732	13.357
May 13	12.891	12.606
May 20	13.066	12.691
May 27	12.857	12.482
June 3	12.897	12.422
June 10	12.598	12.223
June 17	12.305	11.930
June 24	11.973	11.598
July 1	12.045	11.670
July 8	12.204	11.829
July 15	12.315	11.940
July 22	12.377	12.002
July 29	12.629	12.254
Aug. 6	13.015	12.640
Aug. 12	13.376	13.001
Aug. 19	13.616	13.241
Aug. 26	13.735	13.360
Sept. 2	13.722	13.347
Sept. 9	13.649	13.274

Source: "The Mortgage Corporation, Weekly Commitment Activity"; compilation by NAHB Economics Division.

EXHIBIT F

Total Demand for Housing in the 1980s 23 Million Units



Housing Demand in the 80s

The total demand for housing in the 1980s is expected to be 23 million units (including mobile homes).

Natural population growth is expected to account for a demand of 7.42 million units.

Another 6.46 million in demand is expected to come from an increase in the headship rate. The headship rate is the ratio of the number of households to the total population. This rate is expected to increase as the number of people in the 15-24 age group declines, and the 25-34 and 35-64 age groups (who are more likely to form households and buy homes) are increasing at record rates.

Household demand from newly arrived immigrants is expected to total 1.39 million over the decade.

With all of these new households, the housing market will need additional vacancies to provide adequate flexibility of the movement of people in and out of units. This demand is estimated at 1.40 million.

And finally, we estimate that 6.33 million units will be demanded for the replacement of accidental losses, depreciation, and second homes.

Taken all together, this means that we must produce 2.3 million units per year to satisfy America's housing demand. When housing production drops to the low level predicted this year, we fall further behind in trying to achieve this goal.

EXHIBIT G

HOUSING AFFORDABILITY

[$65,000 house; $61,750 mortgage amount (5 percent down); 30-year term]

Interest rate	Monthly payment	Related housing expenses [1]	Annual income needed to afford [2]	Numder of households who can afford (in thousands)	Percent of households who can afford	Number of families priced out (in thousands)
Percent:						
10	$542	$215	$36,336	10,070	17.6	
10½	565	215	37,440	9,440	16.5	630
11	588	215	38,544	8,754	15.3	686
11½	612	215	39,696	8,067	14.1	687
12	635	215	40,800	7,381	12.9	686
12½	659	215	41,952	6,694	11.7	687
13	683	215	43,104	6,008	10.5	686

[1] Real estate taxes, hazard insurance, utilities, maintenance, and repairs.
[2] Assumes ¼ of income goes to housing expenses and constant under writing criteria.

Source: National Association of Home Builders.

Senator BENTSEN. Our next witness is Ms. Cushing Dolbeare, president of the National Low Income Housing Coalition.

If you will proceed, please.

STATEMENT OF CUSHING N. DOLBEARE, PRESIDENT, NATIONAL LOW INCOME HOUSING COALITION, WASHINGTON, D.C.

Ms. DOLBEARE. Thank you very much, Senator Bentsen.

I am delighted to be able to be here to participate in the hearings today. I might say that I agree with much of what has been said so far, but that the National Low Income Housing Coalition has a different perspective because while a healthy housing industry is of great importance to low-income people, mostly because they get hurt even worse than they are already hurting if the housing industry isn't healthy, a healthy housing industry in and of itself, does not necessarily benefit the low-income people who have the most critical housing problems because they operate really in a market of their own.

To a degree, in the existing housing market, the housing programs that are needed to deal with the housing problems of low-income people are really very critical and differ, I think, from the kinds of programs and recommendations contained in Mr. Smith's testimony, because there is no way that we have been able to figure out that the housing problems of low-income people can be met without involving substantial expenditures on the part either of the Federal Government or of State or local governments.

So the Low Income Housing Coalition has a tremendous interest not only in the scale of housing programs, but also how to design low-income housing programs so we can keep their costs as low as possible, and spread their benefits to everyone who needs them.

My prepared statement begins with a definition of decent housing, starting with the traditional definition of it being good quality housing, physically sound housing.

There are about 6 million households in this country now who occupy housing that does not meet minimum standards of housing quality, that has something seriously wrong with it, something which is likely to be a threat to health or safety.

More importantly, decent housing has to be within the means of people who live in it. I think that right now that is the most critical housing problem that faces low-income people.

We have estimated that at least 10 million families in this country now are forced to pay more than 50 percent of their income for shelter.

Now, about 20 percent of those families are homeowners, and a number of those homeowners would be young families with two wage earners who, in a sense, can afford the effort and investment because they are going to get it back some day as their incomes rise and as their house appreciates.

Some of them are spending 50 percent of their income for housing and they are finding it a struggle.

The other 80 percent or so of households that are spending more than 50 percent of their income for housing are spending it on rental housing, and they are predominantly low-income people.

And this is a tremendous burden on them. It means two things. It means that they often have to forgo other necessities.

It also has a major consequence in the rental housing market because if you are spending 50 to 60 percent of your income for housing nominally, there are times when you simply can't pay your rent.

And if you can't pay your rent, then your landlord can't afford to keep you there very often. So one of the things that has contributed to the cycle of the withdrawal of rental housing from the market and the abandonment of rental housing has been the fact that there is a gap between the amount that low-income people can afford to pay for housing and what it costs to keep decent housing on the market.

This is leaving aside the question which is a very important question of the profitability of investing in housing on the part of an investor.

But at an income of $6,000 a year, at 25 percent of income, you are talking about $150 a month for total housing costs. Now, obviously, there is not much housing available.

Senator BENTSEN. Give me that again.

Ms. DOLBEARE. Yes, at an income of $6,000 a year, you are talking about $150 a month, roughly, as being what housing should cost if it's going to be available to you at 25 percent of your income.

One of the things that has been happening in the housing market has been the development of a tremendous gap at the lower end of the income scale.

In 1970, there were roughly as many housing units available for less than $83 a month, which is what a household pays, earning $4,000, can afford to pay, there were roughly as many units in the housing stock that cost less than $83 a month as there were households with incomes below $4,000.

Now—not even now—1977, the most recent figures available from the annual housing survey, there was a gap of more than 3 million units. That is, there were more than 3 million more households with incomes below $4,000 than there were units that were costing less than $83 a month.

Well, I think it's probably clear that the number of units that are available for less than $83 a month now is negligible.

Yet, we still have several million households with incomes that are that low. So we need to find some way of dealing with that problem.

In spite of the efforts which have been made which the Coalition fully supports to expand low income housing programs, we estimate that that gap at the bottom of the income scale is growing at the rate of one-half million units a year.

So we are going to need to address that. We are falling far short, but we are in the process of what we have called a moratorium by attrition.

In 1976, Department of Housing and Urban Development placed 517,000 units under program reservation for its low income housing programs.

That number has fallen steadily so it's my understanding that this year the Department of Housing and Urban Development expects to place approximately 200,000 units under program reservation.

Now, the level of financial commitment has stayed roughly the same. It has not been increased in real terms to compensate for increases in cost.

So that we are finding that we are really falling very badly behind. Now, in contrast to what is happening on the assisted housing sector stand, what is happening through tax expenditures for housing.

I know there has been a great deal of concern that the financial commitment that has been made for housing programs, housing outlays, has been increasing.

They are still less than 1 percent of the Federal budget. But they have been increasing every year. On the other hand, the major Federal commitment to housing has been through the tax system, the major Federal housing costs are through the tax system, primarily because of homeowner deductions.

But, also, because of the cost of various tax incentives enacted in order to stimulate production of rental housing. You will find an analysis in my prepared statement, which we did, which is admittedly fairly crude, but is the best approximation we could make.

If you take direct expenditures and tax expenditures for 1980, and this is based on information in the Federal budget this year, $4.2 billion of all direct and indirect housing expenditures, mostly direct, will go to people with incomes below $5,000, and $7.5 billion, or one-quarter of all direct and indirect housing expenditures will go to people with incomes above $50,000.

We think one of the most important things that the Joint Economic Committee could do would be to take a look at the whole array of Federal housing assistance through the tax system and directly in order to see what the most efficient way is of achieving the national housing goal of a decent home for every American family. Thank you very much.

[The prepared statement of Ms. Dolbeare follows:]

PREPARED STATEMENT OF CUSHING N. DOLBEARE

Low Income Housing Needs, Trends, and Programs

The National Low Income Housing Coalition is a broadly based coalition of organizations and individuals concerned with all people for whom lack of decent housing at costs they can afford is a reality. Our primary focus is on programs to meet the housing needs of very low income people, whose problems are most acute.

We appreciate the opportunity to testify today on the important topic of "housing and the economy." Our statement analyzes trends in housing as they affect low income people, comments on federal housing programs and activities, and concludes with recommendations on the scope and scale of efforts which will be necessary to achieve the national objective of "a decent home and a suitable living environment for every American family."

I. HOUSING TRENDS AND HOUSING NEEDS

All too often, our definitions of housing quality and availability have been shaped by the kind of data—primarily census data—that have been available. It is important, as a basis for discussing housing policy issues, to break away from such concepts, to attempt to define what we mean by decent housing, and then seek the data necessary to let us know what must be done to achieve it.

We suggest defining decent housing as follows:

Decent housing is soundly built, watertight, weathertight and energy efficient, with enough rooms to provide reasonable privacy for its occupants, and with adequate cooking and plumbing facilities, heat and cooling as climate dictates, and ventilation.

Decent housing is within the means of the people who live in it. This means that total cost, including utilities, should be no more than 25 percent of income.

Decent housing provides people with choices of location, of tenure, and price. This requires an adequate housing supply, including a range of housing types in every community and public policies that both prevent displacement and provide equal housing opportunity to all, regardless of race, nationality, color, sex, religion, income, or household composition.

Provision of decent housing, under this rubric, requires improvement and conservation of the existing stock; construction of new housing; and measures to prevent displacement, to provide equal opportunity of access, and to reduce or stabilize housing costs.

Housing quality has been the traditional measure of housing "need." Fortunately, it has improved markedly in recent years. In 1940, 45.2 percent of all dwellings lacked some or all plumbing facilities and 17.8 percent were dilapidated or needed major repairs. By 1970, only 6.5 percent of all dwellings lacked plumbing and 4.6 percent were dilapidated or needed major repairs. Much of this improvement has been brought about by expansion of the housing supply. Nevertheless, housing quality is still a major problem, particularly for minority people and people living in nonmetro areas.

As of 1977, there were an estimated 5.7 million households living in physically inadequate housing: 2 million elderly households; 1.5 million nonelderly single individuals; 1. 5million two-parent households with children present; 0.7 million single-parent households with children present; and 0.5 million couples, with no children. Four-fifths of these households were income-eligible for section 8. One-third were minorities. One-third were homeowners. Almost two-fifths (39 percent) lived outside metropolitan areas.

The National Low Income Housing Coalition is convinced that few people live in seriously substandard housing by choice. The persistence of substandard housing is a reflection of the need for more adequate housing programs.

Housing size and type

Almost half (49.8 percent) of all households now consist of one or two persons. Only 6.9 percent consist of six or more persons. There are, of course, more large poor families. In 1977, there were 13.8 million households with incomes below 125 percent of poverty. 1.1 million (8.4 percent) consisted of six or more persons. However, 8.6 million (63.1 percent) were one- or two-person households. The incidence of poverty is highest for single persons and large families. 37.7 percent of all unrelated individuals had incomes below 125 percent of poverty in 1977, more than half (54.6 percent) of them over 65. The proportion of households with incomes below 125 percent of poverty was 38.5 percent of families of nine or more; 35.7 percent for families of 8; 29.8 percent for families of 7; and ranges from 13.5 percent to 19.9 percent for families of two to six. (Source: Current Population Reports: Characteristics of the Population Below the Poverty Level: 1977, tables 44 and 45.)

Because the housing needs of large, low-income families are so desperate, it is often easy to forget that there appear to be plenty of large units in the housing stock. In fact, for both renters and owners there are more small households than there are very small units. For owners, the disparity is particularly great. There are, for example, 2.7 million renter households of five persons or more and 8.7 million rental units with five rooms or more. Conversely, there are 22.1 million one- or two-person owner households, but fewer than 300,000 owner-occupied units of two rooms or less.

Clearly, these data show that there is room for innovation and new approaches to meeting housing needs for large families. Do we, for example, need to try to induce developers to build new rental projects for large low-income families, or would we be better off all around if we found ways to permit these families to purchase their own homes on the existing market? In how many parts of the country is the housing shortage so tight that this would not be workable?

Affordability

Housing affordability is the most critical housing problem facing low income people. A basic principle underlying most housing programs has been that people should pay no more than 25 percent of their incomes for gross shelter costs. Indeed, these costs account for just under 25 percent of the BLS "lower living standard" for a family of four.

The lower one's income, the higher the proportion one pays for shelter. In 1977, the median shelter-cost/income ratio for renters was 25 percent; for households with a mortgage, it was 19 percent; and for those owning free and clear, it was 12 percent. But the median shelter-cost/income ratio was over 35 percent for renters with incomes below $5,000, mortgaged owners with incomes below $7,000 and owners without mortgages with incomes below $3,000. At the other end of the scale, the median ratio for renters with incomes above $35,000 was less than 10 percent, as it was for owners without mortgages. Mortgaged owners with incomes above $35,000 paid a median of 12 percent of their incomes for gross shelter cost, including taxes, utilities, maintenance, and insurance.

Additional data from the 1977 Annual Housing Survey, conducted by HUD and the Bureau of the Census, show that:

Over 5.8 million households paid over half their incomes for shelter, including utilities. On these, 72.2 percent were renters; 19.8 percent were mortgaged owners; and 8 percent owned free and clear. 19.2 percent were black and 7.2 percent were Hispanics. While 8.9 percent of all households paid over half their incomes for shelter, 15.1 percent of all black households and 12.1 percent of all Hispanic households did so. [Note: The figures giving this breakdown are limited for owners to single-family units on less than 10 acres and with no business on the property—80.9 percent of all owner-occupied units. The figures for renter-occupied units include only those on less than 10 acres. Since this is 98.9 percent of all renters, the figures are probably on target. If figures were available for all owner-occupied units, the total number paying over half their incomes would increase. So would the proportion of owners paying this much.]

Over 4.9 million households paid 35–49 percent of their incomes for shelter in 1977; 9 million paid 25–34 percent, 9.9 million paid 20–24 percent, and 29 million paid less than 20 percent. These data are for 58.8 million households, or 78.2 percent of all households. (*Source:* 1977 Annual Housing Survey, part A, table A–2.)

In 1976, about one-fifth of all households could not afford adequate housing at one-fourth of their income, but the burden of housing affordability was unfairly and unequally distributed. Those who could not afford decent housing were:

19.7 percent of all U.S. households, including 27.2 percent of all renters and 15.7 percent of all owners.

37 percent of all black households, including 43.2 of all black renters, and 28.9 percent of all black owners.

29.3 percent of all Hispanic households.

19.1 percent of all large households.

47 percent of all female-headed households.

41.3 percent of all elderly households.

26 percent of all rural households.

Because of rising housing and energy costs, these proportions would be doubled today. Moreover, the number of units appropriate for households with incomes below $10,000 is dropping sharply, while increases in the inventory are primarily for upper-income households.

The impact of high housing costs exacerbates the income gap between rich and poor. For example, in 1977, the median very-low-income renter (below $3,000) paid $120 monthly for shelter, including utilities. The median renter with more than 10 times the income paid only 2½ times as much rent. In other words, after allowing for shelter costs, the richest renter households had more than 20 times the disposable income of the poorest renters. Moreover, there were almost 6½ times as many renters in the lowest income group as in the richest. [The specifics, from the 1977 Annual Housing Survey, are: (1) median rent for the 3,521,000 renter households with incomes below $3,000 was $120; (2) median rent for the 545,000 households with incomes above $35,000 was $300.]

The housing shortage and its impact

In 1968, when the goal of providing 6 million low- and moderate-income housing units in 10 years (still far from met) was established, housing costs were a fraction of what they are today. Two decades ago, almost anyone with a steady job who was not discriminated against in the housing market could purchase decent, reasonably priced housing and finance it at rates below 6 percent. Median sales prices of new single family homes were just under $25,000. We built millions of suburban houses and met the housing needs of millions of families.

Today, all that has changed. Housing prices have almost trebled and interest rates are more than double their 1968 levels. Since 1968, the Consumer Price Index for home purchase has risen from 102.8 (1967=100) to the January 1980 figure of 242.1. Family income for most of the period kept up with the CPI as a whole, but fell behind the increase in home ownership costs.

To afford new housing today, you have to (1) already own a house and be able to sell it and purchase another one; (2) be in the top 20 percent of the income distribution; (3) be willing and able to spend much more than 25 percent of your income for housing; (4) be one of the lucky few to obtain new subsidized housing; or (5) buy a mobile home.

Moreover, there is a tightening housing shortage, which keeps up the prices of existing housing. Another 10-year goal set in 1968 was to produce 26 million new or rehabilitated units, a rate of 2.6 million units a year. This was to allow for household formation, replace units that were abandoned or removed from the stock, replace bad housing, and provide enough vacancies for some elbow-room. Even including mobile homes in the count, this goal has never been met. The closest we came was in 1972, when 2.4 million units (including mobile homes) were produced. In all, over the 1968–78 decade, the shortfall was 8.4 million units.

The Disappearance of Private, Low-Rent Housing.—The housing shortage is worst for rental units. For the first time in a century, the stock of rental housing is shrinking, not expanding. Losses of units because of abandonment, demolition, or conversion are outrunning additions through new construction or other means. This contraction, moreover, comes at a time when rental housing need is at an all-time high, and growing. New household formation will hit peak levels during this decade, and the high cost of home ownership—both the initial sales prices and financing costs, when financing is available—mean that many of these new households will be foreclosed from the opportunity to purchase housing.

This is not a low-income housing problem, per se, but it greatly intensifies the housing problems of low-income people, who always come in last in housing markets. Moreover, new rental housing production is now largely dependent on government assistance, both directly and through various provisions of the internal revenue code.

One major aspect of the housing shortage, which is often overlooked, is the disappearance of private low-rent housing from the market. One measure of this is that, between 1970 and 1977, median rents increased by 70 percent, from $108 to $184 per month, while renter household incomes increased by only 40 percent, from $6,300 to $8,800 annually. Between 1976 and 1977, the number of households paying more than half their incomes for shelter increased by 11.5 percent.

Given the way energy and other costs have increased, it seems safe to assume that at least 10 million households now pay over half their incomes for shelter. Even if these households were relatively affluent, there would be cause for concern. Some of them are: Mostly younger, upwardly mobile households who are stretching themselves to purchase, either by choice and partly as an investment or because they can find nothing to rent. But the vast majority are poor people. Paying over half their incomes for shelter means that they must do without other necessities of life.

One reason this is happening is because low-cost units are disappearing from the market. At a 25 percent rent-income ratio, a household with an income of $4,000 can afford to pay $83.33 per month for rent, including utilities. A household with a $6,000 income can pay only $125. A family of four with a poverty level income could pay about $140.

In 1970, there were 7,584,000 renter households with incomes below $4,000 and an estimated 7,516,000 rental units available for gross rents (including utilities) of $83 or less. In other words, need and supply were roughly in balance, looking only at households and rents, ignoring the real and significant factors of quality, suitability, and availability. (In fact, a substantial proportion of these low-rent units on the private market were occupied by households with incomes above $4,000, while many low-income households paid much higher rents.)

By 1977, the situation had changed significantly. While the number of renter households with incomes below $4,000 had shrunk to 5,815,000, the number of low-rent units (below $83 per month) had dropped to 2,052,000, leaving a gap of 3,763,000 units. In other words, even after allowing for attrition, there was a net loss of over 500.000 units annually at rents the lowest income households could afford. By now, we estimate that the number of unsubsidized units renting at $83 or less is negligible. But there are still several million households in this bottom income group.

Home Ownership Has Lessened the Need for Housing Subsidies.—The situation for owners is different, and less urgent. In 1977, there were 4,426,000 owner households with incomes below $4,000, and there were 187,000 units with mortgages and 5,928,000 units owned free and clear with total monthly housing costs below $83. In other words, there was no absolute gap at that time. It would seem clear, however, that rising energy and other costs have, by now, created one.

Had we not, through a variety of Federal housing policies and programs, made it possible for many moderate income people to become homeowners in the last three decades, we would now have even greater need for assisted housing for low income people. About 45 percent of all households with incomes below the poverty level are homeowners. Many need housing assistance, in the form of energy payments or help for maintenance or taxes. With few exceptions, they have paid off their mortgages, and own free and clear. Had they not been able to build up this equity, they too would be dependent upon Federal housing assistance programs to obtain decent housing at costs they can afford. In 1977, for example, 4.8 million, or 30.1 percent, of the 15.3 million households with incomes below $7,000 owned their homes free and clear. Of these owner households, 60.3 percent (2.8 million) paid less than 25 percent of their incomes for shelter (utilities, taxes, insurance and maintenance) and 78.3 percent (or 3.6 million households) paid less than 35 percent of their income for shelter.

Yet, by limiting housing programs for very low income people to rental programs only (with the exception of the FmHA 504 home repair program), we are preventing today's low income families from building up equity and reducing their needs for housing assistance in the future.

II. FEDERAL HOUSING PROGRAMS

Unlike food stamps, Medicaid or public education, housing assistance is not available as a right to all who qualify. Moreover, shrinking program levels make it clear that it is not likely to be recognized as one in the near future.

A major reason is that historically housing programs have been approached in terms of bricks and mortar, not people. In the earliest days, during the 1930's, assisted housing was viewed primarily as a means of providing employment. Housing projects were built to create jobs, and low income people designated as occupants were only secondarily the beneficiaries of the programs. [Unlike the present, at least the jobs created through housing were created by building low income housing.] Later, as emphasis moved toward rehabilitation, the housing problem was still posed in terms of structures: for example, how to rehabilitate substandard units.

Initiators of housing programs have seldom begun by asking the basic questions: Who needs housing assistance? How should eligibility be determined? What sort of assistance should then be granted?

All Federal subsidized housing programs for low and moderate income people have one thing in common: the program level is determined by an annual appropriation, intended to cover a discrete number of units (but never adequate to do so). Sponsors apply for these units in a competitive process and, eventually, they are made available to low and moderate income people. But only a small fraction of eligible households actually occupies assisted housing, and an even tinier additional fraction is able to do so each year. Whether or not a given low income family gets a unit is largely a matter of luck or persistence.

Moreover, except for Section 8, the subsidy mechanisms assume a minimum level of revenue from each project, which requires a minimum level of rental income. That translates into selecting tenants who can pay the necessary rents, which means either screening out people with very low incomes or charging them very high proportions of their income for rent.

Where the sponsors or owners of the projects were unsatisfied with these constraints and attempted in spite of them to serve very low income families, they created many of the difficulties associated in the public mind with subsidized housing. Rental income was inadequate to support and maintain viable projects. If they were public housing, they deteriorated. If they were nonprofit housing, they frequently went into default. Efforts to deal with these built-in problems through providing operating subsidies have consistently been too little and too late.

Low income people do not now have a right to housing assistance. Other people do.

FHA and VA insurance, for example, is available to everyone who qualifies for it and can find an acceptable unit. The scope of these programs is not constrained by a Federal appropriation level (although it will be next year). Instead, the constraints come in the supply of housing and the demand for it by qualified purchasers.

An even more pervasive entitlement in housing is provided through the Federal income tax system. Homeowner and investor deductions are available as a right to all eligible to use them. Moreover, the higher your income, the more help you get from Federal tax subsidies. (See discussion of this point below.)

In other words, housing entitlements are related to income. The higher one's income, the greater one's entitlement. Housing is the only major social problem which has this perverse relationship. In other areas, such as public highways and public education, programs and services are either available to all, without income test, or, if they are income-based, they are related to income below a specific threshhold, not above it.

The cost of assisted housing programs

Somehow a myth has come into being about low income housing programs. According to this myth, the Federal government has poured billions of dollars each year for several decades into low income housing programs that haven't worked, don't work, and can't be made to work.

The truth is that housing does cost the Federal government billions of dollars each year—but not housing for poor people. Moreover, the truth is that we do know how to provide decent housing for low income people, but we have been unwilling to make the commitment required to do so in more than token amounts.

Clearly, the cost of housing assistance has become a major concern to Congress and the Administration. As program levels and costs have increased, assisted housing payments have been rising rapidly, as the following table shows. (Figures through 1979 are actual; 1980–83 are estimates):

Year	Units under payment	Amount (billions)
1973	1,768,115	$1.6
1974	1,969,583	1.8
1975	2,125,601	1.8
1976 plus transition quarter	2,397,515	2.8
1977	2,649,650	2.9
1978	2,817,582	3.6
1979	3,031,979	4.4
1980	3,253,000	5.1
1981	3,477,000	6.3
1982		8.0
1983		9.4

These housing payments are the annual contributions which the federal government is obligated to make under annual contributions and other contracts which provide housing assistance. Actual units under payment at the end of 1979 were:

Sec. 8	898, 441
Sec. 235	235, 187
Sec. 236	541, 460
Rent supplements	178, 891
Public housing	1, 178, 000
Total	3, 031, 979

Almost all of the increase anticipated by 1981 is in the Section 8 program. These are units already in the pipeline: under reservation or construction but not yet occupied. The units approved for 1980 and 1981 will not require housing payments until they are occupied: generally within two years for existing units; longer for substantial rehabilitation and new construction. The housing assistance payment contracts under the Section 8 public housing program run for 15–30 years (lowered this year from a former 40-year maximum). Budget authority is the annual cost (contract authority) multiplied by the term of the contracts. Of the budget authority requested by HUD for 1981, $10.1 billion is for 30-year contracts; $0.6 billion for 28-year contracts; $10.6 billion for 20-year contracts; and $6.1 billion for 15-year contracts. Thus, a substantial amount of the 1981 appropriation will not be spent until after the year 2000.

This manner of financing and budgeting for assisted housing has serious consequences. No one can now predict either tenant incomes or housing costs for such a long term. Experts in the field disagree on whether budget authority overestimates or underestimates the cost of the housing. But one thing is clear: the amount of budget authority required to provide even a very inadequate level of housing assistance is so substantial that it is difficult to foresee how this nation's commitment to providing decent housing for low income people can be met without some major changes in approach.

But the total of all the assisted housing payments ever made under all HUD assisted housing programs, from the inception of public housing in 1937 though 1979, is less than the cost to the Federal Government of housing-related tax expenditures in 1979 alone. Moreover, while housing payments will increase from $3.6 billion in 1979 to an anticipated $6.3 billion in 1981, housing-related tax expenditures will increase from $22.3 billion in 1979 to $24.3 billion in 1980 and $28.9 billion in 1981. They will probably top $40 billion by 1985, barring changes in federal income tax laws.

Assuming that the beneficiaries of direct and tax expenditures are arrayed, by income group, as they were in 1977, the latest year for which such an analysis is available, we would find that, for 1980:

$4.2 billion, or 14.1 percent, of all direct and indirect housing expenditures will go to people at the bottom of the income scale, those with household incomes below $5,000. Only one household in eight will receive housing assistance, and the average monthly expenditure, per recipient, is $132.

$7.5 billion, or 25.5 percent, of all direct and indirect housing expenditures will go to people with incomes above $50,000. More than four-fifths of all households in this income bracket will receive tax benefits, and the average monthly amount per recipient is $309.

$16.7 billion, or 56.4 percent of all direct and indirect housing expenditures, will go to people with incomes between $20,000 and $50,000. Two fifths of all households in this range will receive housing benefits and the average amount per recipient is $67 per month.

Only $1.2 billion, or 4.0 percent of direct and indirect housing expenditures, will go to households with incomes between $5,000 and $10,000. Fewer than one household in ten in this income range will receive housing benefits, and the average monthly amount, per recipient, is $60.

In other words, only 18 percent of tax expenditures will go to people with incomes below $10,000; another 11 percent will go to people in the $10,000–$20,000 income range; all the rest will go to people with incomes over $20,000. And these expenditures are increasing at a rate that exceeds direct outlays for housing lower income families, whose need is clearly greater.

Surely, if we can afford the $3–5 billion annual increases that are occurring in tax expenditures, we can afford an adequate level of support for assisted housing.

In addition to their inequity, homeowner tax expenditures, which account for over 90 percent of all housing-related tax expenditures, have had major and for the most part unhealthy, impacts on urban development. Coupled with relatively low housing costs, high production, and easy financing in a discriminatory real estate market, they must bear a major share of responsibility for the growing segregation of American society by race and income since the end of World War II. During the 1950's and 1960's, most white families with incomes—even relatively low incomes—could, if they chose, purchase new housing. Blacks could not, regardless of income. Only 127,000 of the more than 5 million owner-occupied units added to the housing inventory between 1960 and 1970 were occupied by blacks—less than 3 percent.

The interplay between the homeowner subsidies and tax deductions for rental housing has exacerbated the problems of inner cities and contributed to condominium conversions. The investor deductions for rental housing have built in disincentives for continued ownership over the life of the property, and thus for high quality of construction and management.

There is a real danger, however, that efforts to redress the imbalance in tax incentives by stimulating reinvestment in central cities will further burden poor and minority people. By stimulating reinvestment and encouraging the return of affluent white people, the immediate result is often displacement, without relocation assistance or subsidies necessary to obtain alternative housing, of low income minority people. An immediate example here is the impact of the 1976 provisions to encourage the rehabilitation of structures in historic neighborhoods—many of which also turn out to be low income neighborhoods.

The combination of homeowner deductions, which stimulate demand, and the run-out of investor depreciation, which forces people to sell is a major factor in the rising tide of condominium conversions. In addition to this impact, and their expense, the investor deductions are highly inefficient. In a recent study, the Congressional Budget Office (CBO) described them as "simply a device to provide government subsidy for building construction." CBO found: "only about half of what the shelter subsidy cost the government in lost revenue, however, ever reaches builders and developers. The remainder goes in the form of payments to the outside investors for the use of their money, and in fees to the syndicators, lawyers, and accountants who are needed to put together and sell the tax shelter package.

"In addition, less than two-thirds of the estimated $1.3 billion a year the government loses in tax revenue from real estate tax shelters is used to subsidize construction of rental housing. The remainder subsidizes the construction of office buildings, shopping centers, and other commercial buildings. And of the total subsidy, only about 11 percent is used to assist low and moderate rental housing construction. The rest of the rental housing share provides subsidies for middle and upper income rental housing."

In spite of this, measures to add to tax incentives for rental housing construction are being seriously considered by the Congress.

III. RECOMMENDATIONS

The housing problems of low income people will not be met without a major reorientation of federal housing policies and programs. To start with, we need to find a mechanism for reviewing, simultaneously, both direct and tax expenditures on housing, of capping the runaway increase in housing-related tax expenditures, and developing an adequate set of programs to meet our housing needs equitably and efficiently.

We need to move to new ways of approaching the provision of housing assistance without losing the momentum we now have. And we must end the moratorium by attrition that has been under way since 1976.

I believe it is possible to develop a comprehensive housing program, at no greater cost than our present financial commitments to low income housing, which would deal effectively with the housing problems of low income people; conserve and rehabilitate our present housing stock; and provide the necessary support for a high rate of housing production. Before outlining the components of such a program, let me state several specific objectives which any comprehensive housing program should meet:

It should assist all inadequately housed people desiring help to deal with problems of housing quality, housing affordability and housing choice.

It should improve and conserve the existing housing stock and existing neighborhoods.

It should provide an adequate supply of new housing.

It should be responsive to consumer, neighborhood, and community needs and preferences.

It should minimize the cost to the federal government, including hidden subsidies.

The touchstone of Federal housing policy should be to give highest priority to those with greatest needs: low income and minority people. Furthermore, we should structure our programs so that they are oriented toward serving people and their neighborhoods. A major objective should be to place control of the housing stock in the hands of its occupants. This need not necessarily mean home ownership for everyone, or even use of condominiums and cooperatives instead of rental housing. It could, for example, be done through community of neighborhood-based housing corporations and through provision for genuine tenant participation in housing management. Especially in low income areas, the potential of tenant or community ownership of rental housing has been seriously underestimated. In terms of total cash flow, such areas often have a higher per square mile income stream than most affluent areas. Renters in such areas typically pay absentee landlords well over 25 percent of their incomes. Keeping this rent money in the community would provide a major economic stimulus. Moreover, tenant or community ownership would eliminate many of the problems caused by absentee owners, leading to better maintenance and lower operating costs.

A major challenge is to design housing programs so federal, state, and local institutions will all be responsive to low income people and their needs. Federal assistance should recognize that housing is a basic human right. They should be both flexible and strike a balance between the necessity of a federal government role in guaranteeing and protecting the rights of individuals and providing the resources to meet their housing needs, and the desirability of carrying out policies and projects under some manner of democratic local control.

The Coalition has developed, for discussion and consideration, the framework of a comprehensive housing program with three major, interrelated components. None can stand alone and be expected to deal effectively with housing problems. Carried out together, they can. The elements of the program are:

First, an entitlement to housing assistance—through housing allowances or expansion of the Section 8 existing program—for all very low income people, to pay the difference between the amount they can afford and the monthly cost of the housing they need (whether they are renting or buying with the assistance of other programs).

Second, a program of housing block grants to provide funds which can be used responsively to meet community and neighborhood needs. Block grant funds should be limited to providing assistance, including such activities as tenant organizing, counselling, and technical assistance as well as housing improvement, rehabilitation, or construction, to people who are now eligible for Section 8 or public housing.

Third, greatly expanded assistance to new construction to provide for the housing needs of low and moderate income people. Special emphasis should be on providing housing in areas with low vacancy rates and for groups with least adequate housing, such as farmworkers, Indians, and elderly or handicapped people. Priority should be given for home ownership, at least for families with children, and to housing produced for community-based nonprofit or public agencies.

Our approach would, we recognize, dramatically increase outlays for housing assistance within a fairly short period. But it would probably fit within our present levels of budget authority, and would be able to be more responsive to changes in needs, as well as meet them more adequately. The entitlement program would, we believe, cost about $10 billion, and would serve all very low income households, not a small fraction of them, as at present. It would slow down housing abandonment, stimulate moderate rehabilitation, and enable poor people to keep up with rent increases. Housing block grants at a level of $5 billion could penetrate a variety of programs suiting local needs. They would, for example, permit institution of programs such as shared equity or other forms of assistance to tenants new being displaced by condominium conversions. This would leave a substantial amount for a range of new construction efforts focussed on urgent, unmet needs and, if we moved to front-end or capital subsidies with suitable recapture provisions, could probably generate far more units than our present programs. One important point: to the extent that rental housing is supported by such programs, it is imperative that there be adequate restrictions on prepayment or conversion, so that housing intended for low or moderate income people will remain so.

We believe that this approach will prove to be both sound and feasible, and we hope that it can be considered in future years. Meanwhile, we cannot, in view of the increasing needs of low income families, afford to diminish our present levels of support for the lower income housing programs of HUD and the Farmers Home Administration. Indeed, we cannot, in decency, proceed at our present pace, with the problem outstripping our efforts to solve it. We cannot afford to stretch out commitments to a limited number of units for 15–30 years, while leaving untouched the critical housing needs of millions of others. We need to seek and find alternatives. The National Low Income Housing Coalition stands ready to assist you in this effort.

Senator BENTSEN. All right. You raise some interesting questions.

Mr. Thygerson is chief economist and staff vice president of the United States League of Savings Associations. You have been before the committee before, and we are pleased to have you back.

STATEMENT OF KENNETH J. THYGERSON, CHIEF ECONOMIST AND STAFF VICE PRESIDENT, U.S. LEAGUE OF SAVINGS ASSOCIATIONS, CHICAGO, ILL.

Mr. THYGERSON. Yes; I have. Thank you very much, Mr. Chairman.

You and the committee are to be commended for the timeliness of this hearing. The housing recovery is at a critical stage. Certain conditions threaten to stall or even reverse it. Fortunately, as I will discuss in a moment, there are actions this Congress can take, yet this year, to improve the situation.

As you mentioned last fall I had the honor to testify before this distinguished committee. I presented evidence at the time showing the relationship between the level of inflation, interest rates, and housing production.

At the time, I had forecast a sharp decline in housing starts in 1980 as a result of runaway inflation, and concurrently, high interest rates. This forecast proved valid and this housing recession was accurately forecast.

Housing starts were hurt by the rise in interest rates but have staged a recovery since May. Mortgage rates dropped 4 percentage points in 2 months and the response of homebuilders and buyers was immediate and encouraging.

On the other hand, there is significant question whether this recovery has substance and can be sustained. There has already been a rapid climb in short-term interest rates since June with T-bills reaching levels this week not seen since the end of April.

Already this is translated into mortgage rates 1½ percent higher than the June lows.

Second, the recovery to date has occurred without the customary support of strong savings flows at specialized home lending institutions—our Nation's savings and loans and mutual savings banks.

I will describe the pattern of savings flow since January 1979. These savings flows to savings and loans associations and also mutual savings banks are largely the result of the policies of the depository institutions' deregulation committee and its predecessor.

The reactions have proved a shift in market share. The total stock of retail savings has shifted away from the thrift sector in favor of the commercial bank as illustrated in table 1 of my prepared statement.

Without reinstatement of the housing differential on the popular 6 month money market certificate denied to us by the Deregulation Committee the outlook for housing in the near term suggests a "stall" or even possibly a reversal of the recovery we all hoped for.

Third, the unregulated money market mutual funds have diverted billions of dollars for housing in the mortgage market, as shown in table 2 of my prepared statement. Despite their checkwriting convenience features, money funds are free from the reserve requirements now applied universally to all depository institutions.

This freedom from reserves further complicates monetary policy, as well as drains deposits from home-town investment into the CD's of giant, money-center banks, Wall Street securities, and international investments.

The recovery may be short lived, as well, because it depends on undependable financing sources and mechanisms. Many sales in recent months utilized assumptions, wrap-arounds, "taking back" of second mortgages by sellers, and other "creative financing" devices. Many home buyers and sellers are not in a position to prudently use such arrangements.

Another questionable contribution to the recovery has been that of tax-exempt mortgage revenue bond financing. These programs are inflationary, sporadic, inequitable, and insufficient. They inflate local market prices by encouraging sellers to raise their asking prices by the equivalent of the lowered financing costs for buyers, and of course, their exemption from Federal taxes adds an uncontrollable element to your efforts to minimize our Federal deficit.

Mortgage revenue bonds, available in only a minority of States, provide their "subsidy" indiscriminately through time and region. They operate inefficiently since much of the proceeds go to reserves, underwriters, and middlemen. In sum, we must be concerned that our recovery is built on a flimsy foundation.

Next, even with the improvement earlier this summer, mortgage rates are at double-digit levels. For a growing percentage of potential first-time buyers, and many others too, we have evidence that the limits of housing affordability have been reached and surpassed.

Finally, as you, Mr. Chairman, have pointed out repeatedly and effectively, our Nation's continued low levels of personal savings must be considered a disturbing "negative" to prospects for a sustained recovery, given the demands facing housing production in the decade ahead.

Now for my recommendations, as described in my prepared statement.

First, we recommend that the Congress correct the misguided decisions of the Depository Institutions' Deregulation Committee by instructing the regulators to reinstate the "housing differential" on retail savings for the duration of the 6-year period for phasing-out savings rate ceilings described in Public Law 96–221. There is no single, more potent action this Congress could take to improve housing prospects.

Next, to stem the uncontrolled diversion of resources to the unregulated money funds. and assist in the conduct of monetary policy, we would recommend that the Congress prohibit checkwriting powers for money funds, or at a minimum, impose reserves.

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Third, we call upon the Senate to speedily process H.R. 5741, the bill passed by the House earlier this year to impose meaningful restraints on use of tax-exempt mortgage revenue bonds by States and localities.

Fourth, we need to stimulate new deposits at the housing-specialized thrift institutions, and at regulated financial institutions generally. Under your leadership, Mr. Chairman, the Congress took an important first step in this direction with the enactment of the $200–$400 exemption from Federal taxation for the first portion of interest and dividends received from domestic sources.

The tax cut bill approved by the Senate Finance Committee would take another important step by broadening the eligibility for systematic, long-term retirement savings, as well as raising IRA account contribution limits.

Another important goal for housing-specialized institutions would be a reasonable opportunity to bid for "public funds." Senator Magnuson's S. 2800, by extending Federal insurance coverage to every dollar of governmental deposits, would make that possible.

Finally, we would strongly endorse the recommendation of this distinguished committee that any tax cut bill be directed to increasing productivity, savings, investment, and reducing inflation, and should be accompanied by vigorous efforts to reduce or eliminate wasteful Government spending.

The fact that we are in a recessionary period does not alter our belief that it would be a mistake to force-feed spending programs.

A less-inflationary policy mix, with emphasis on balanced budgets and private investment, would make possible a lasting recovery in housing and more balanced economic growth for the future.

I have appreciated this opportunity to present the views of the U.S. League and look forward to your questions.

Senator BENTSEN. Thank you, Mr. Thygerson.

[The prepared statement of Mr. Thygerson follows:]

PREPARED STATEMENT OF KENNETH J. THYGERSON

My name is Kenneth J. Thygerson. I am chief economist and staff vice president of the U.S. League of Savings Associations.* The U.S. League appreciates this opportunity to present its views on the current state of the housing market and our forecast for 1980 and 1981.

Mr. Chairman, you and members of your committee are to be commended for the timeliness of this hearing. The housing recovery, now only 3 months of age, is at a critical stage in its development. Certain conditions are present which threaten to stall or even reverse it. Fortunately, there are actions that the Congress can take, yet this year, to improve this situation. Thus, your hearing could not have been better timed.

Let me begin by focusing first on the housing outlook for the remainder of 1980 and 1981. This will be followed by a discussion of those factors which have put into peril the recent uptick in housing sales and production. I will conclude with a list of recommended actions which could help to assure that our infant recovery reaches adolescence.

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*The U.S. League of Savings Associations (formerly the U.S. Savings and Loan League) has a membership of 4,450 savings and loan associations representing 99⅔ percent of the assets of the $540 billion savings and loan business. League membership includes all types of associations—Federal and State-chartered, insured and uninsured, stock and mutual. The principal officers are: Ed Brooks, President, Richmnd, Va.; Rollin Barnard, Vice President, Denver, Col.; Lloyd Bowles, Legislative Chairman, Dallas, Tex.; William O'Connell, Executive Vice President, Chicago, Ill.; Arthur Edgeworth, Director-Washington Operations; and Glen Troop, Legislative Director. League headquarters are at 111 E. Wacker Dr., Chicago, Ill.; and the Washington Office is located at 1709 New York Ave., N.W., Washington, D.C.

HOUSING OUTLOOK: A WEAK RECOVERY BUILT ON A FLIMSY FOUNDATION

Current economic and monetary trends provide an unusually murky setting in which to assess future housing market prospects.

On the one hand, housing starts, new and existing housing sales have all staged a vigorous recovery from the low points reached in April and May 1980. This rebound was prompted by the record decline in short- and long-term interest rates from the peaks reached in March and April to the lows reached in June and early July. During this period, average mortgage rates offered on 80 percent single-family loans dropped from an estimated record high of 16.32 percent to 12.19 percent, a drop of over 4 percentage points in only two months. As expected, the response of homebuyers to such a precipitous decline in rates was immediate and encouraging.

On the other hand, a number of significant factors put into serious question whether this recovery has substance and can be sustained. First, the recent precipitous climb in short- and long-term interest rates since June threatens the housing recovery. This rise in money costs has already been translated into a substantial increase in mortgage interest rates of up to 1.5 percentage points since June. Second, the recovery in housing has largely occurred without the traditional impetus of strong savings flows at specialized mortgage lending institutions (thrifts) and the simultaneous rise in mortgage credit availability. This factor is largely the result of extremely adverse policies of the Depository Institutions Deregulation Committee (DIDC) on May 28th of 1980. This action resulted in a substantial decrease in the market share of deposits going to specialized mortgage lenders. Third, the uncontrolled growth of money market mutual funds has channelled billions of dollars from housing and the mortgage market. Fourth, what recovery has occurred has been partially based on undependable financing sources such as tax-exempt mortgage revenue bonds and so-called creative financing techniques. These two sources of mortgage funds do not represent the type of strong foundation upon which a sustained and vibrant recovery must be built. Fifth, recent housing trends provide clear and persuasive evidence that reasonable limits of housing affordability have been reached and exceeded for a growing percentage of potential first-time home buyers. Finally, the impact of continued low levels of personal savings must be considered a negative in view of record capital demands facing our economy.

Despite the seemingly persuasive evidence of a recovery in housing production and sales, it is our considered opinion that it is both premature and risky to extrapolate from the last few months of improved numbers and conclude that a sustained recovery in housing will occur over the balance of 1980 and early 1981. Rather, if interest rates remain near present levels or go higher and if the recent actions of the DIDC are not reversed, we must conclude that the recent improvements in starts will soon reach a plateau or even possibly reverse themselves late in the third quarter or early in the fourth quarter of 1980.

Overall, we anticipate that housing starts will fall to 1.2 million units in 1980, the lowest level since the disastrous housing year of 1975.

The outlook for 1981 is, of course, less certain. Hopefully, the recent climb in interest rates will trend downward later this year or early next year. If this were combined with a return by the DIDC of the savings rate differential on all small-denomination accounts especially the six-month money market certificate, at specialized mortgage lending thrifts, then a recovery to the 1.4–1.5 million unit level or higher is attainable for next year. Without these two factors, however, I must again stress that the outlook for housing next year is one of great uncertainty. In large part it rests on two unknowns. First, will the forces of inflation subside so that interest rates can return to levels that again make housing affordable? Second, will the actions of the DIDC—which have thwarted a recovery in thrift savings flows and lending—be reversed? These are difficult questions to answer at this point.

REVIEWING THE FACTORS AFFECTING THE HOUSING OUTLOOK

In order to develop and implement housing policy it is essential that the key factors affecting the market be isolated and evaluated. Given the potentially dark clouds hanging over the housing market at present, it is essential that those factors that stand in the way of continued recovery, as enumerated above, be examined in turn.

INTEREST RATES AND INFLATION

Last fall I had the honor of testifying before this distinguished Committee. I presented evidence showing the historical relationship between the level of inflation, interest rates and housing production. At that time, I had forecast a sharp decline in housing starts in 1980 as a result of runaway inflation and, concurrently, high interest rates. This analysis proved valid and this year's housing recession was forecast accurately.

Unfortunately, the root cause of inflation—a fiscal imbalance aggravated by consumption-stimulus Federal spending—continues. There can be little doubt that the number-one cause of our inflation stems from our inability to achieve a more balanced monetary/fiscal policy stabilization mix.

Over the past year, many have pointed to OPEC-induced energy price increases as the primary cause of double-digit inflation. However, in recent months oil prices have stabilized and even fallen slightly, yet double-digit inflation continues. It is not valid to point only at OPEC when the primary cause of inflation is domestic in origin. Every effort must be made to increase budgetary discipline at all levels. The current recession must not be an excuse to initiate new spending programs, expand existing programs or give up on the public's desire to reduce the overall burden of government on the economy.

In this respect, we heartily endorse the recommendation made in the Midyear Report 1980, The Recession and the Economy of the Joint Economic Committee, which stated: "Any tax cut that Congress enacts during the next year should be carefully targeted to improve productivity, reduce inflationary pressures, and create jobs in the long run." [1] We strongly believe that a reigniting of inflationary pressures is the greatest risk to the economic health of the country. As a result, we also strongly endorse the Committee's recommendation that, "Any tax cut should be accompanied by systematic and vigorous efforts to reduce or eliminate unnecessary and wasteful government spending." [2]

DIDC AND THE HOUSING DIFFERENTIAL

One characteristic of every sustained housing recovery in the post World War II period has been a substantial increase in savings inflows into specialized mortgage lending thrift institutions—our savings and loan associations. This, in turn, was followed by sharp declines in mortgage interest rates, sharp increases in savings flows and loan commitments and, finally, mortgage lending. It has been the improvement in thrift institution savings flows that has provided the firm foundation for every sustained post-war housing recovery.

This firm foundation for a housing recovery has not been laid in 1980. Rather, on May 28, 1980, the Depository Institutions Deregulation Committee (DIDC), established under Public Law 96–221 to administer savings rates and gradually over six years bring ceilings to market level (but not beyond), acted to eliminate (in whole or in part) the housing differential on the very popular 6-month money market certificate (MMC) when Treasury rates are below 7.50 percent or above 8.50 percent. They also acted to allow commercial banks to roll over outstanding MMCs of their customers at the higher thrift rate. And they established "floors" on rates for the MMC and 30-month small-saver certificates (SSC) to sustain higher ceilings if, and when, general market rates relaxed (as happened in June).

These actions effectively eliminated any chance for a pick-up in household savings flows at specialized mortgage lending institutions, and, in effect, aggravated a situation initially produced by the old Coordinating Committee of Federal financal regulators on March 15, 1979, when the housing differential on the MMC was eliminated as Treasury rates rose above 9.00 percent. As it turned out, until May 1980, the MMC rate remained above the 9.00 percent for all but two weeks since March 15, 1979, and the full-service commercial banks competed at equal MMC ceilings with the specialized housing lenders during that span.

The combined impact of the March 15, 1979, and May 28, 1980, actions has been to alter substantially the market shares in household over-the-counter savings to the detriment of specialized mortgage lending thrifts. This, in turn, has resulted in severe negative consequences for the mortgage and housing markets.

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[1] Joint Economic Committee, "Midyear Report, The Recession and the Economy," the Economy, p. 24.
[2] Ibid., p. 25.

Evidence of this is provided in table 1. The table shows the market shares between commercial banks and savings and loan associations for household time and savings deposits; the data excludes the large-denomination certificates of deposit which are customarily sold to corporate treasurers and other money market investors. The data covers the years 1970–1979 and the first half of 1980. The most relevant statistics in the table relate to the average market shares from 1970 through 1978 and shares for 1979 and 1980. As shown, during the 1970–78 period, when the housing differential was in place, the savings and loan market share averaged 48.8, while that of the commercial banks averaged 51.2 percent. In 1979, as a result of the March 15 elimination of the differential, the association market share dropped to the lowest point in the decade, 36.9 percent. In 1980, impacted by both the March 15, 1979, and May 28, 1980, actions, the market share for savings and loans plummetted still further to 22.4 percent.

TABLE 1.—MARKET SHARES OF THE INCREASE IN HOUSEHOLD RETAIL SAVINGS FOR SAVINGS AND LOANS AND COMMERCIAL BANKS, 1970–80

[Dollar amounts in billions]

	Savings and loans		Commercial banks		Total for savings and loans and commercial banks
	Change in savings	Market share	Change in savings	Market share	
1970	$10.8	63.5	$6.2	36.5	$17.0
1971	27.0	45.5	32.4	54.5	59.4
1972	31.4	52.2	28.8	47.8	60.2
1973	19.3	42.9	25.7	57.1	45.0
1974	15.0	37.9	24.6	62.1	39.6
1975	41.5	48.0	44.9	52.0	86.4
1976	48.4	65.2	25.8	34.8	74.2
1977	48.0	46.6	54.9	53.4	102.9
1978	39.4	37.0	67.0	63.0	106.4
1979	25.7	36.9	44.0	63.1	69.7
1980 (1st half)	10.4	22.4	36.0	77.6	46.4
Average for period 1970 through 1978		48.8		51.2	
Average for period 1979 through 1st-half 1980		29.7		70.3	

Sources: Federal Reserve: Federal Home Loan Bank Board; U.S. League of Savings Associations, Economics Department.

The rate differential on time and savings deposits is critical to the outlook for housing. Without savings flows, savings and loan associations, the principal supplier of residential mortgage credit, cannot support a sustained recovery in housing. Without reinstatement of the "housing" differential, the outlook for the housing market in the near term suggests a stalling—or even a possible reversal—of the recovery now taking place. Next year's outlook also is suspect if the DIDC actions are not reversed.

A WEAK FOUNDATION

Despite the lack of strong and sustainable mortgage lending support from savings and loan associations, there has been some improvement in housing starts and sales over the depths of March and April sales. This improvement is built on a weak and undependable foundation. To some extent, this recovery has been prompted by supply of mortgage credit from two unusual financing vehicles: (1) tax-exempt mortgage revenue bonds; and (2) so-called "creative financing techniques".

The use of tax-exempt mortgage revenue bonds by state agencies and local municipalities has expanded substantially during 1980. These bonds have provided lower cost mortgage credit as a result of their tax-exempt status in twenty or so States.

The cost of this subsidy is borne by all Federal taxpayers—who must make up the lost revenue (tax expenditures) to the Treasury in this form of higher taxes or, alternatively, suffer the consequences of higher inflation as a result of expanded budget deficits. The impact of these bonds on the housing market is difficult to estimate precisely since much of the funds is put into reserve accounts and dissipated through fees to underwriters, servicers, and other middlemen.

However, it is true that their use thus far in 1980 has contributed to the modest housing recovery now taking place.

Unfortunately, these bond programs have proven to be inflationary, undependable, inequitable, and insufficient. The expansion of these programs: (1) inflates local home prices by encouraging the seller to capitalize the buyer's lower finance cost into a higher price; (2) increases the Federal Budget deficit, thus adding to inflation pressures; (3) provides the subsidy indiscriminately through time and regionally; and (4) operates inefficiently since much of the proceeds is used for administrative purposes. Also, as we have seen, the programs are undependable since they are influenced by the relative interest-rate spreads between tax-exempt and taxable rates. Thus, in recent months these issues have become less economical to issue. Mortgage bond activity has also congested the bond markets—thus adding to the financing costs of general public improvements which depend upon the tax-exempt markets for funds.

Another factor supporting the recovery has been the large growth in so-called creative financing techniques. This involves such approaches as mortgage assumptions, wrap-around lending, seller financing and second mortgages. All of these approaches are complex, and not all home buyers and sellers are capable of utilizing them. Many of these creative techniques result in a more expensive home financing solution for the home buyer and they often represent temporary arrangements awaiting the availability of traditional sources of permanent financing. As a result, this type of support can also be inequitable and undependable.

In sum, we have built our just-born recovery on a flimsy foundation. The recovery does not have the benefit of dependable sources of credit which historically have been available during recovery periods in the past. The contribution of the savings and loan business is missing. Moreover, these sources of funds are undependable. These facts also suggest that the recovery will be weak and may well stall or reverse itself in future months.

UNREGULATED MONEY FUND GROWTH

One destabilizing feature of the current economic cycle has been the rapid and uncontrolled growth of the money market mutual funds. Although these institutions were in existence during the 1974–75 period, their growth and impact on the financial markets was insignificant when compared to the current cycle. Through the first half of 1980, the money funds reached over $75 billion in assets; over $65 billion of this growth occurred in the last 1½ years.

The appeal of these funds has been enhanced by two considerations: (1) the funds have been allowed to offer banklike transaction account services to enhance the liquidity of their accounts without the costs of regulation or reserve requirements; and (2) the funds have benefitted by the shift in monetary policy toward targeting monetary growth rates rather than interest rates. The change in monetary policy conduct last October uniquely favors short-term, highly liquid investments because such a policy leads to more violent swings in interest rates than a policy of interest-rate targeting.

The growth of the money funds represents a problem for our nation's monetary authorities as well. Because money market fund balances are highly liquid, there is no question that the ability of the Federal Reserve Board to control and monitor the growth of the monetary aggregates is hampered. It is inconsistent that when the Depository Institutions Deregulation and Monetary Control Act (Public Law 96–221) was passed, the money market funds were not brought under reserves similar to those which now apply universally to other depositories.

Table 2 vividly displays the extraordinary growth of the money market funds relative to associations. During the last 1½ years, the growth in money funds has been $65.6 billion versus $36.1 billion for associations. With money fund assets concentrated in large bank CDs, bankers acceptances, Government and agency securities and Eurodollar investments, there can be no doubt that considerable resources have been diverted from the mortgage market into other investments.

TABLE 2.—SAVINGS AND LOAN SAVINGS INCREASES AND MONEY MARKET FUND INCREASES, 1974–1ST HALF 1980

[In billions of dollars]

	Savings and loans increase	Money market funds increase
1974	$15.0	$1.7
1975	41.5	1.9
1976	48.4	-.2
1977	48.0	.4
1978	39.4	7.0
1979	25.7	34.4
1st half 1980	10.4	31.2

AFFORDABILITY: A SERIOUS PROBLEM

For a number of years, housing affordability has been mentioned by housing economists as a serious threat. In 1980 it has become a reality. We are all aware that the housing market of the 1980s is potentially the strongest ever as a result of the sustained growth in the population of 25 to 34-year-olds: the primary first-time home buying market. Unfortunately, the affordability problem threatens to diminish this effective demand.

Clear evidence of this was developed by the U.S. League of Savings Associations in a recent survey of 1979 home buyers. The resulting study "Homeownership: Coping with Inflation" (a copy has been submitted to the committee), disclosed that between 1977 and 1979 the percentage of first-time home buyers had dropped by half from 36 percent in 1977 to only 18 percent in 1979. As compared to the 1977 first-time buyers, the 1979 homebuyers had substantially higher incomes and had to rely more on second incomes within the household. Fewer of them had children. They also were slightly older. All these factors evidence a real affordability problem for first-time buyers.

This is even more true in 1980. The 1979 survey was accomplished when housing prices and mortgage rates were much lower than today. Without question, the affordability problem documented in 1979 has become more severe. As a result, the strong housing markets projected by many in the 1980s may well prove to be wishful thinking. In any event, the housing outlook for the balance of 1980 and in 1981 is not likely to be bright—with affordability as a major constraint to significant recovery.

SAVINGS DISINCENTIVES REMAIN

Last fall when the U.S. League of Savings Associations testified before this Committee, we made the strong recommendation for reversing our existing disincentives to save. We were overjoyed by the work of Chairman Bentsen and his successful effort to achieve the $200/$400 tax exclusion for interest and dividends included as an amendment to the oil tax bill.

Despite this important step, we must renew our appeal to obtain additional tax incentives to save. The $200/$400 exclusion is a step in the right direction, but it basically provides some tax equity for only the nation's small savers. We must now provide incentives for all potential savers if we are to redress the bias of the Internal Revenue Code against savings and truly improve our productive capacity.

If our nation's capital needs are to be met and our dismally low personal savings rate reversed, we must continue to press for savings incentives. Unfortunately, the inflationary psychology which has impacted our economy since the late 1970's has not been reversed, despite the recession. Households still are not saving, and our personal savings rate remains near its all-time low. This factor continues to contribute to our inability to generate funds for a sustained housing recovery.

Again we strongly endorse the recommendation of your Committee that any tax cut bill should be ". . . directed at reducing personal rates in order to stimulate work, savings, and investment at the individual level." [3]

[3] Ibid., p. 23–24.

Apart from the tax law changes, there is another immediate action which Members of the Senate can take to improve the flow of funds to housing-specialized institutions. That is, to support S. 2800, Senator Magnuson's bill—pending as an amendment to H.R. 2255, awaiting floor action—to provide full, 100 percent insurance for the deposits of governmental units, known as "public funds". Currently, statutes in most States require collateralization of public funds beyond the established ($100,000 per account) insurance limits of the FSLIC and FDIC. Collateralization is a paperwork-ridden and highly inefficient way to protect the public's monies. One effect of the collateralization process is to provide a virtual monopoly for commercial banks for these accounts, since they readily possess the surplus securities used to secure deposits.

Full Federal account insurance would open such funds to other depositories, including savings and loan associations. Public funds are frequently stable, long-term deposits aptly suited for long-term lending. In a report to the Senate Banking Committee, the impartial Advisory Commission on Intergovernmental Relations concluded: "full deposit insurance of public funds would result in better service and higher returns for such deposits by all types of financial intermediaries." Congressional approval of S. 2800 would open this new source of funding for the needs of home buyers and home sellers.

RECOMMENDATIONS

Given this rather pessimistic view of housing prospects for this year and the next, we offer this Committee the following recommendations:

(1) Reinstate the "Housing" Differential

There is no single, more potent action the Congress can take to improve housing prospects than to require that the DIDC reimpose the differential for all retail-type savings accounts offered by housing-specialized savings and loan associations.

Savings flows and mortgage lending trends at associations since March 15, 1979, provide irrefutable evidence that the "housing" differential is essential to a smoothly-functioning mortgage market. The actions of the DIDC on May 28, 1980, have exacerbated this situation.

The 1980s promise record levels of potential housing demand as the postwar "baby boom" generation reaches the age of household formation. Failing to satisfy that demand, or at least a substantial portion of it, will only put further pressure on home prices and make the task of reducing inflation even more difficult than it is already. Tax-exempt mortgage revenue bonds, government subsidies, and the burgeoning variety of "creative" financing techniques are no substitute for supervised, specialized housing finance institutions. The nation needs its housing finance system—the savings and loan system—now more than ever before.

(2) Eliminate Unfair Advantages of Money Market Mutual Funds

The impact of the uncontrolled growth of the unregulated money market mutual funds is a contributing factor to our pessimistic housing outlook. Congress could improve this outlook by taking away those advantages of the funds that are not available to regulated depository institutions.

Extreme interest-rate variability has produced an environment in which holders of money balances seek to preserve maximum flexibility to respond to rate movements. This environment has been particularly conductive to the growth of money market mutual funds, which offer relatively small denominations, provide a checking-type privilege (through penalty-free withdrawals), and yield returns that approximate short-term interest rate movements (with a slight lag).

In large part, the advantage of the funds stems from their ability to offer check-type services to provide maximum liquidity. These services are provided in direct competition with regulated depositories, most of whom will not even be authorized (under Public Law 96–221) to offer a interest-paying transaction account (NOW account) until December 31, 1980. Moreover, the money funds are not required to hold nonearning reserves at the Federal Reserve Banks as required of all other depositories as a result of the Depository Institutions Deregulation and Monetary Control Act.

It is essential that Congress eliminate this competitive inequity by: (1) eliminating the check-writing services of the funds; and/or (2) requiring that reserves be held against these balances.

(3) Restrict the Use of Tax-Exempt Mortgage Revenue Bonds

H.R. 5714, passed by the House, must clear the Senate this year.

The unrestricted growth of tax-exempt mortgage revenue bonds has acted to exacerbate inflation, and increase the costs of financing essential state and local projects. The influx of subsidized mortgage credit increases inflation pressures in two ways. First, the low cost mortgage money makes it possible for home sellers to capitalize the lower cost credit available to buyers into higher selling prices, thereby increasing home prices. This occurs when a subsidized buyer uses the subsidy to pay a higher price than he could otherwise afford for a house, or alternatively, when a seller asks more than he otherwise would because he knows that the buyer will have a subsidized mortgage. Second, the burgeoning increase in tax-exempt bonds reduces Federal tax revenues, thereby increasing the Federal Budget deficit. The result is inflation.

At the same time, the growth in these issues puts upward pressure on tax-exempt bond rates. As a result, the cost of financing essential state and local expenditures is increased or alternatively, the projects must be postponed. (In the week of August 25, the Dow Jones municipal bond index moved to its highest level ever, 9.70 percent.) This exceeded the previous peak in April 1980 during the height of the Federal Reserve's tight money program. These bonds must be restricted immediately.

(4) Additional Tax Incentives for Savings and Access to Public Funds Are Needed

Congress should include broadly-based new tax incentives for savings in any tax cut bill passed in 1980 or 1981.

The \$200/\$400 tax exclusion of Public Law 96–223 represented a significant first step in reversing our country's existing tax bias against savings. Public Law 96–223 is an important signal to the American people about the importance of savings and its vital role in increasing productivity, decreasing inflation and raising the standard of living for all Americans. But, the \$200/\$400 exclusion does not go far enough.

To begin with, we strongly recommend at a minimum, that the Congress make the \$200/\$400 exclusion a permanent feature of our tax code. It was unfortunate that the Conference on Public Law 96–223 did not see fit to extend the benefits of this tax modification for savings beyond 1982. It is vital that the American people be provided with assurance about what they will receive in aftertax return from savings decisions they make today. This strongly suggests the need to make the exclusion a permanent small saver incentive.

Beyond that recommendation, a special U.S. League Subcommittee has examined a broad variety of proposals for stimulating savings through tax code revisions. We find two—the "universal IRA" and incentives to "reinvest"—of especial merit.

The decision of Congress in 1974 to expand the Keogh plan approach to provide an Individual Retirement Account for those not qualified for pension programs opened an important new source of funds for depository institutions. IRA accounts permit some wage-earners to deduct \$1,500 annually (or \$1,750 in a joint account with an unemployed spouse) as part of their tax planning, with taxation of contributions and earnings postponed until retirement years. This self-help incentive obviously relieves the potential burden on our social security and Railroad Retirement System, while helping to compensate for the inequities imposed on retirement security by unanticipated inflation.

We would recommend strongly that the Congress expand the IRA program in three ways:

Permit individuals to establish a separate Individual Retirement Account even if they are covered by existing qualified pension plans where they work or, in the alternative, permit workers in qualified plans to receive a tax deduction for contributions made for existing company programs; the legislation (H.R. 5829, as amended) recently approved by the Senate Finance Committee incorporates this important change in IRA eligibility;

Provide full, rather than limited and supplementary, coverage for the non-employed spouse based upon the earnings of the family wage-earner;

Raise the annual contribution levels for which deductions are available beyond the \$1,500/\$1,750 limits now applicable to at least the \$1,750/\$2,000 levels proposed recently by the Senate Finance Committee.

In our analysis, these "universal IRA" changes are particularly effective in building the personal savings base. They provide a potent incentive to increase the nation's net new savings because of the wide range of eligible taxpayers. They also provide the greatest increase in long-term savings of any tax incentive plan we have studied since they encourage systematic, annual contributions, while locking-in funds until age 59½. Like other deferral approaches, the funds invested in IRA do not "escape" taxation fully—though beneficiaries are generally taxed in years when lower tax brackets apply.

The appeal of the "universal IRA" is somewhat diminished for those taxpayers in their early wage-earnings years . . . their 20s and 30s . . . because of the demand on family resources and the severity of penalties for withdrawal of funds before retirement. In recognition of this problem the Congress might consider this further refinement: a one-time privilege to withdraw a portion of IRA funds prior to age 59½ without penalty subject, of course, to reasonable limits.

Needless to say, we have been encouraged by and strongly support the amendments in the Senate Finance Committee tax cut bill for a broadened IRA program.

The second major tax incentive for savings we recommend for your attention is a tax-deferred rollover for reinvested interest on savings accounts. (This could be applied to reinvested interest from other sources or reinvested dividends from stock, as well.)

Such an incentive would encourage longer-term, systematic savings. As long-term mortgage lenders, such deposits are particularly appropriate for savings and loan associations—though we are not suggesting that the tax break be limited to our depositors. The "reinvested savings" incentive would allow savers to take full advantage of the compound interest on income earned from most savings accounts by removing the increased tax bite which diminishes the effectiveness of such accumulations. It would also allow savers to manage their investments to a greater degree than is possible, say, under the IRA/Keogh savings plans. Again, the ultimate impact on Federal revenues is lessened since taxes are deferred, not excused.

Another important legislative initiative would provide full, Federal insurance coverage for governmental deposits. As mentioned above, prompt Congressional approval of S. 2800 added recently as an amendment to House-passed H.R. 2255 in the Senate Banking Committee, would accomplish this objective. Such action would enable housing-specialized lenders to bid competitively for public unit accounts—funds largely unavailable to home finance today because of outmoded and inefficient State collateralization requirements.

(5) Maintain the Goal of a Balanced Federal Budget

We strongly endorse the recommendation of the Joint Economic Committee that any tax cut bill should be directed to increasing productivity, savings, investment, reducing inflation and should be accompanied by vigorous efforts to reduce or eliminate wasteful government spending.

We must achieve a new discipline to control our country's Federal Budget. We have had the tendency to try to spend our way out of nearly ever economic slowdown or recession rather than putting the emphasis on monetary policy and capital formation.

The fact that we have already entered a recessionary period does not alter our belief that it would be a mistake to forcefeed spending programs to buy us out of a recession. A less inflationary policy mix—which emphasizes private investment and balanced budgets—would make possible a lasting more balanced economic growth. The private sector would not be forced to compete with Treasury financings to obtain capital.

This concludes my testimony. The U.S. League has appreciated this opportunity to discuss the outlook for housing—a critical national priority in the decade ahead. I look forward to your questions.

Senator BENTSEN. Ms. Dolbeare, when you are talking about tax expenditures and the distribution of those tax expenditures for housing, I assume that a major portion of what you refer to is housing interest, is that correct?

Ms. DOLBEARE. Yes; and there are some capital gains deductions. I can submit some details for the record. But the bulk of it is homeowner deductions, about $4 billion, I think, are investor deductions.

Senator BENTSEN. Investors in homes?

Ms. DOLBEARE. No; for rental housing.

Senator BENTSEN. You are talking about rental housing, I see.

Ms. DOLBEARE. Total cost is estimated at approximately $30 billion for 1980 of all of the housing-related tax deductions. This is the Treasury estimate.

Senator BENTSEN. Yet, obviously one of the things we want to promote in this country is homeownership.

Ms. DOLBEARE. That's correct. I think that one of the things that I would hope that the Joint Economic Committee would look at is the balance between the need to promote homeownership, and indeed there is a section in my prepared statement which I skipped over which strongly advocates the need for low-income homeownership programs being both more satisfactory from a consumer point of view and also probably cost effective compared to rental housing for large families.

But a large amount of the mortgage interest and property tax deductions goes not to people in the middle-income bracket but people with much higher income, and the Joint Economic—Joint Committee on Taxation has estimated that these tax expenditures will double in approximately 5 years.

I think that what we need to do is not to repeal them but to find some way of keeping them. And the other thing I think that we need to do is recognize that if we are willing as a matter of public policy and implicity, I think we are, to in effect subsidize homeownership at the rate of $20 billion or so a year, then we shouldn't be so reluctant to mount low-income housing programs which might also provide a subsidy that might cost $20 billion or so a year.

Senator BENTSEN. Well I am. For example, I assume tomorrow I will be proposing the extension of the tax benefit for low-income housing in the Finance Committee. That is very essential and I think makes a major contribution.

On the other hand we should remember that those people over $50,000 a year in income constitute 2.7 percent of the returns, and contribute some 26 to 28 percent of the taxes. So, that is the other side of that coin.

I recognize your argument. And I want very much to promote homeownership to the extent we possibly can. Where we can't, I will try to encourage something to help what I think is a real crisis in rental housing right now.

Do you have any policy options specifically aimed at alleviating that kind of a shortage in rental units?

Ms. DOLBEARE. Toward the end of my prepared statement there is a proposal for a comprehensive kind of attack on housing problems, particularly for low-income people, which consists of three parts.

The first of which would be, in effect, a housing allowance program or an entitlement for very low-income households, that is, people with incomes below the poverty level, well below the current levels of eligibility for assisted housing to deal with the problem I described, the gap between the amount of housing costs and the amount they can afford to pay for shelter.

The second component of that program would be a housing block grant program which would be available to local communities limited to providing housing assistance for people in the bottom half of the income scale. That would provide local flexibility for whatever seemed to be the most urgent needs in those communities.

And the final component which we haven't really flushed out would be Federal assistance for meeting housing production needs where there are low prices, and I think certainly there we would want to explore some continued incentives or production of rental housing.

This is a consequence of the homeowner deduction, that rental housing is going to require some kind of assistance because if new rental housing is going to rent for $500, $600, to $700 a month, people who can afford to pay those rents can also afford to purchase, and they can take a tax deduction.

So that you have a drying up of the market for new rental housing which is provided without subsidy, and if we are going to have new rental production, we are going to have to have some way of finding some assistance in producing that.

Senator BENTSEN. Mr. Thygerson, Mr. Janis, chairman of the Federal Home Loan Bank Board, states that savings and loan associations may be in for the worst year they have had since World War II.

Do you agree with that?

Mr. THYGERSON. Absolutely. You saw the figures, I suspect, reported yesterday by the Federal Home Loan Bank Board on earnings. That showed a return on average assets, I believe it was 17 basis points in the first half of this year. That is the lowest we have had in the postwar period.

We have some early returns in, unfortunately, on the third quarter numbers. They show a deterioration from the first half.

As you know, the money market certificates peaked out in April at something around 16 percent. They began then to fall off, and it looked as though things were going to improve 6 months later as these things rolled over into lower interest rates. We now find the interest rate pattern going the other direction.

So, where we expected to be coming out of this very serious earnings situation toward the fourth quarter of this year, we now see the prospects for that improvement diminishing quite rapidly in light of the rising interest rates.

Senator BENTSEN. Mr. Smith, you and Mr. Thygerson apparently don't agree on some of these types of mortgage revenue bonds.

Mr. SMITH. No, sir, I believe our two industries are slightly at opposite ends of the poles on this. We have found that, I believe, a majority rather than a minority of the States are using the banks. I know in my own hometown, a bond issue of $100 million, in the last 90 days, went with the rate to the buyer being 9.4. That wouldn't happen this week.

But the people that purchased these houses were quite satisfied with the result.

Mr. THYGERSON. If I could just rejoin——

Senator BENTSEN. What do you think will happen to our financial institutions if we continue down that course?

Mr. SMITH. Let me say this. I would hope we have a lasting solution. We have seen, I believe, in the local communities, Mr. Chairman, a demand for housing, a concern by the local elected officials and State elected officials in some States to be so strong that they have come forth with these programs because they were the only way at that time of housing the people.

One of the things that we find to be very interesting—and I believe it is a statistic that we haven't been keeping up with in our own industry—are units lost. Today, we found from the Census Bureau that units lost in 1977, standing in 1976—and by the way, this is as early as we can find statistics—were 1,398,000.

Senator BENTSEN. What do you mean lost?

Mr. SMITH. I will let Mr. Sumichrast explain this because there are three or four categories, destruction, fires, eminent domain.

Senator BENTSEN. You mean no longer existing?

Mr. SMITH. Mr. Sumichrast, perhaps, would you bring us up to date on this?

Mr. SUMICHRAST. About half of these are lost because of demolition. The rest are lost due to changes in use from residential to nonresidential, fires, floods, conversion to other uses. The point here is that the number is rather startling.

I always thought if we are losing about 1 percent of the inventory—we had about 80 million units, roughly, over the last 25 to 30 years and it was shown by the Bureau of the Census that we lost about 1 percent—roughly, we would be losing this year about 800,000 units. That number which I got this morning from Census is much higher than that, but that figure includes such things as vacant mobile homes—which are considered losses to the housing stock—and other categories of units which may not permanently have the existing inventory.

Of this, 435,000 are multifamily units lost. We are building only about 100,000 private rental units a year now.

So, the major loss, and that is why we call it net removal rate, is among the multifamily structures. It obviously creates an enormous problem for the low-income segment of the housing inventory.

I will supply a fuller explanation for the record.

[The following information was subsequently supplied for the record:]

UNITS LOST TO THE HOUSING STOCK BETWEEN OCTOBER 1976 AND OCTOBER 1977

CURRENT TO PREVIOUS LOSSES (1977 AHS)

[In thousands; all year round housing units]

	Total, all 1977 losses	Type B					Type C			
		Total	Business or storage	To be demolished	Exposed to elements	Other type B	Total	Demolished	Other type C	Other
Units in structure: Total	1,398	547	147	25	177	198	583	171	412	268
1—detached	417	197	67	13	92	25	196	95	101	24
1—attached	41	26	14	1	6	4	12	3	8	3
2 to 4	194	95	32	8	25	30	96	42	54	3
5 to 19	139	73	21	2	30	20	65	27	38	1
20 or more	102	61	10	0	23	29	9	3	6	32
Mobile home or trailer	505	95	3	0	2	90	206	1	205	205

Source: 1977 Annual Housing Survey (AHS) National Unpublished Tabulations. Bureau of the Census, Housing Division, Washington, D.C.

Between October, 1976 and October, 1977, there were 1,398,000 housing units lost to the housing stock. Of these units, 505,000 were mobile homes or trailers and the other 893,000 were conventional units.

The losses to the conventional stock were composed of 458,000 single family and 435,000 multifamily units. The 51–49 percent single-multi split of losses compares to an approximately 70–30 percent split of single-multi units in the remaining inventory. The multifamily stock tends to be older than the single family stock, which is one of the reasons that the loss of multifamily units is disproportionately high.

There are two types of losses to the housing inventory: permanent and retrievable. There were 378,000 permanent losses to the conventional inventory. The largest component of conventional permanent losses was demolitions, of which there were 170,000. Other components of permanent losses are units lost in fires, units lost through natural disasters (floods, tornadoes, etc.), units eliminated in structural conversion, and units that were merged. There were 208,000 permanent single family losses and 170,000 permanent multifamily losses.

Retrievable conventional losses numbered 452,000, of which 223,000 were single family units and 229,000 were multifamily units. Retrievable losses include units to be demolished, units converted to nonresidential use (business, school, or commercial storage), units scheduled to be demolished, units condemned or in which occupancy is prohibited by law, units severely damaged by fire, or units in which the interior has been exposed to the elements (unoccupied units with no doors or windows that are not fit for habitation).

Permanent losses are units that can never return to the inventory and are counted only once over time in the loss series. However, retrievable losses can move in and out of the housing stock. For instance, suppose a unit was residentially occupied in 1973, converted to commercial use in 1974, residentally occupied again in 1976, and demolished in 1977. For the long-term comparison between 1973 and 1977, the unit would be counted only once as a demolition. But for annual estimates of losses, the unit would be counted as a loss to nonresidential use in 1974, an addition in 1976, and again as a loss by demolition in 1977.

All in all, 144,000 of the 893,000 conventional units lost could be retrieved without much difficulty and reconverted into residential use. However, the other 749,000 are either irrevocably lost or could not return to the occupied inventory without a considerable amount of work. These data are the best available, but the Census Bureau has warned that the annual estimates should be used with care because of sampling and nonsampling errors as well as difficulties in processing the data.

Senator Bentsen. Mr. Thygerson, what is the reaction to the negotiable rate on mortgages? Jay Janis was talking about how it was going to provide the needed flexibility to overcome some high borrowing costs.

Mr. Thygerson. Well, we continue to have, of course, the fact that there is a lot of competition in the mortgage market. Savings and loans are not the only, while they are the major lender in the market, they are not the only lender. And, so long as we are confronted with competition, the adoption of a new instrument is a tough adoption in any marketplace.

We are talking about a new product that is not well understood. It may not even be understood by all lenders. It is certainly a difficult product to sell in the marketplace.

We have had some, I would say, extraordinary success with the adoption of flexible rate instruments in the State of California and several other States that have been in this business for a number of years.

We are now seeing, while I don't have any statistics, at least the adoption in the offering of the rollover or renegotiable mortgage in, I would say, most of the States. Part of the problem has to do with the fact that we are dealing with federally chartered and State-chartered institutions.

The Federal Home Loan Bank Board has authorized use for federally chartered institutions. We do have States that because of specific aspects of the usury laws or because the powers of the State-chartered institutions are not similar to federally chartered make it difficult for the State chartered to offer a similar instrument.

That has meant that you don't have uniform adoption of the uniform document, and you don't have a competitive situation in the markets that make it easy to assimilate a new product into the marketplace.

But given that this is only a few months old, I would say it is working well and will probably continue.

Senator BENTSEN. Ms. Kallek, comments have been made concerning adequate housing. Do you have any numbers on that insofar as any regional bias.

For example, lacking plumbing, and so forth?

Ms. KALLEK. The major question, sir, will be included, they are included in the 1980 census of population in housing.

All of the housing will be able to be gaged from that survey, from the census.

Senator BENTSEN. So you don't have anything more current than the last census on that?

Ms. KALLEK. No. We have information from the last census, of course.

Senator BENTSEN. I understand. Ms. Dolbeare, do you have anything on that?

Ms. DOLBEARE. No; we don't. We are prime consumers of the annual housing survey. We don't have the resources to generate our own material.

Senator BENTSEN. It seems that most of the families that are having difficulty in getting housing are often female headed, or they are a minority.

Where are those people living now?

Ms. DOLBEARE. Some of them are living in physically satisfactory housing but paying very high proportions of their income for that housing.

A great many minority people and people in rural areas are living in housing that comes nowhere near close to reasonable standards of decency. There are also households that are doubled up so that you have two households sharing a unit.

In many inner cities you find a fairly high degree of squatting going on. You have housing units that are abandoned that look as though they are not occupied, but you will find people are living in the back rooms in some instances.

So, you find a whole range of housing problems. Basically what you find is that people are either living in substandard housing or paying much higher proportions of their income than they can afford and going without other necessities, or both.

Senator BENTSEN. I guess it's the general consensus here and the concern of all that we are seeing what may not be a long-term recovery in housing. That this may be a blip or abberation. And that these interest rates obviously could cut off the recovery very quickly.

And then we will have a worse recession than we had before. I share that concern with you.

That is one of the reasons we ought to be doing everything we can to try to encourage savings in this country, and that $200 to $400 Bentsen amendment that passed is obviously not enough.

We ought to do much more. As I recall, I had that structured at $2,000, but we weren't able to get that through. At least it's a break in the direction we need.

Thank you for coming. Unless someone feels very strongly about further comments, the committee will stand adjourned.

[Whereupon, at 4:03 p.m., the committee adjourned, subject to the call of the Chair.]

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